# DOCUMENT RESUME

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|---|---|
| ED 171 963 | CE 021 585 |
| TITLE | The Effects of Structural Employment and Training Programs on Inflation and Employment. Hearings before the Joint Economic Committee, Congress of the United States, Ninety-sixth Congress, First Session. (February 9 and 21, 1979). |
| INSTITUTION | Joint Economic Committee, Washington, D.C. |
| PUB DATE | Feb 79 |
| NOTE | 127p.; Not available in hard copy due to small print throughout |
| AVAILABLE FROM | Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402 |
| EDRS PRICE | MF01 Plus Postage. PC Not Available from EDRS. |
| DESCRIPTORS | Employment Level; *Employment Problems; *Employment Programs; Employment Projections; Employment Trends; *Inflation (Economics); Job Market; Job Training; *Labor Market; Manpower Development; Minority Groups; Minority Role; *Unemployment; Youth Employment |
| IDENTIFIERS | Comprehensive Employment and Training Act |

ABSTRACT

Hearings on the effects of structural employment and training programs on inflation and unemployment are presented. The purpose of the hearings is to determine the best approach or mix of approaches to combat structural unemployment. The document is arranged in four parts. The first section presents six witnesses and statements before the Joint Economic Committee of Congress on February 9, 1979. The second section includes six witnesses and statements before the committee on February 21, 1979. A total of nine prepared statements, submitted for the record, are included in sections 3 and 4. "The White Paper on the New Comprehensive Employment and Training Program" and a report on "Programs to Reduce Structural Unemployment" are appended. (LRA)

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# THE EFFECTS OF STRUCTURAL EMPLOYMENT AND TRAINING PROGRAMS ON INFLATION AND UNEMPLOYMENT

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## HEARINGS

BEFORE THE

## JOINT ECONOMIC COMMITTEE
## CONGRESS OF THE UNITED STATES

NINETY-SIXTH CONGRESS

FIRST SESSION

FEBRUARY 9 AND 21, 1979

Printed for the use of the Joint Economic Committee

U.S. DEPARTMENT OF HEALTH,
EDUCATION & WELFARE
NATIONAL INSTITUTE OF
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43-177

U.S. GOVERNMENT PRINTING OFFICE
WASHINGTON : 1979

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# THE EFFECTS OF STRUCTURAL EMPLOYMENT AND TRAINING PROGRAMS ON INFLATION AND UNEMPLOYMENT

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FRIDAY, FEBRUARY 9, 1979

Congress of the United States,
Joint Economic Committee,
*Washington, D.C.*

The committee met, pursuant to notice, at 10:05 a.m., in room 318, Russell Senate Office Building, Hon. Parren J. Mitchell (member of the committee) presiding.

Present: Representatives Mitchell and Brown, and Senator Javits.

Also present: John M. Albertine, David W. Allen, and M. Catherine Miller, professional staff members; Robert Ash Wallace, research director, Special Study on Economic Change; Katie MacArthur, press assistant; Mark Borchelt, administrative assistant; and Stephen J. Entin, Mark R. Policinski, and Peter Turza, minority professional staff members.

## Opening Statement of Representative Mitchell

Representative Mitchell. The hearing will come to order.

We are going to operate under extreme difficulties because we don't have sound equipment up here but it is on the way.

I would suggest for those persons in the audience who might have some difficulty in hearing, that you move up either to one of the side tables or pull your chairs up so you can hear.

Can I be heard in the back? Barely?

This is going to pose some problems for our witnesses. This means that you will have to project pretty loudly for a while until the equipment gets here.

Congress is faced with two undeniable facts—a high rate of inflation and a high rate of unemployment.

There is every indication that these two facts will continue to affect us for some time.

Whatever policy tools we choose to mitigate the effects of inflation cannot be allowed to significantly exacerbate the unemployment rate; and vice versa, our policies to lower the unemployment rate must result in the lowest inflationary cost.

Our task here today is to attempt a determination of the best approach or mix of approaches to combat structural unemployment.

We have all kinds. When I first came to the Congress, there was talk of the new technologies and the fact that had caused structural unemployment.

Subsequently, we have heard an explanation based on geographic reasons and, of course, the matter of racial discrimination.

Although the old adage runs that if you laid all the economists in the world end to end you would never reach a conclusion, we seem to have some agreement among economists that the conventional fiscal and monetary measures cannot be expected to reduce the unemployment rate so as to reach full employment without serious price pressures.

Unfortunately, the employment and training programs so far have been expected to fulfill a hodgepodge of different objectives.

Because no one program can be all things to all people, Congress has become aware of the dissatisfaction with the effectiveness of the current employment and training programs.

I might indicate here also that I am appalled in the decades of cyclical variations of boom and almost bust that black workers have never reduced their unemployment rate below 10.8 percent, teenagers below 15.8 percent, and black teenagers below 32.5 percent during the last 10 years.

If you add to this the underestimation from those unaccounted-for discouraged workers, I think we have a very fatal flaw in the American economy.

What I believe we need to do is to ask some basic questions about where we are going and how much we intend to accomplish for those structurally unemployed workers.

I am hoping that the witnesses before us can direct our attention to the relevant issues. We have asked all of them these two questions:

Question No. 1: Can targeted structural employment and training programs achieve and sustain a decrease in the unemployment rates among those segments of the labor force having special difficulties in obtaining employment?

Question No. 2: Can targeted structural employment and training programs achieve and sustain a decrease in the national unemployment rate without exacerbating inflation?

The administration has characterized the efforts to reduce structural unemployment as one of the important priorities in our economy.

However, their two proposals for the expanded employment tax credit and the incentive to private employers for additional employment of structurally impeded workers admittedly are uncertain as to their efficacy.

Ultimately, Congress has been left with the bulk of decisionmaking as to what are the most useful methods.

So, today we are going to explore a few of those methods and at least find out whether we are in the right ball park.

We are fortunate in hearing from such a distinguished panel with a background of practical policy experience and very fine academic distinction.

Our leadoff witness will be the Honorable Donald A. Nichols, Deputy Assistant Secretary for Economic Policy and Research, Department of Labor. I will introduce the others later.

Congressman Brown has a statement he wants to make at this time.

### OPENING STATEMENT OF REPRESENTATIVE BROWN

Representative **BROWN**. Today's hearing before the Joint Economic Committee addresses what is certainly the most severe economic and social crises facing the country today.

Structural unemployment is not just an economic problem but a problem that demands the attention and action of all truly concerned citizens because of its disastrous effects on the human spirit of thousands of Americans.

It literally is a ticking bomb waiting for some spark to set it off.

General policies aimed at dealing with economic problems do not in general improve the lot of the structurally unemployed.

General economic policies which place a premium on skills, experience, mobility, and training only serve to alienate the structurally unemployed even further because they do not apply to them.

Past Government programs which have been as changeable as the political wind provide the structurally unemployed with no lasting commitment to solving their real permanent problems.

Business and labor groups which have meritoriously attempted to deal with the problem know that their efforts have hardly scratched the surface.

In the end, the structurally unemployed remain desperate and forgotten people for the most part.

I am quite disturbed by the calloused attitude of some economists who tell us that structural unemployment will pass away as the baby boom labor forces ages and that lump moves out of the system.

Never have statistics been so misused in my opinion.

Demographic changes will not provide the training needed by the structurally unemployed to ease their plight.

Demographic changes will not provide the support services needed by the structurally unemployed to become competent in their job search or lasting in their employment.

Demographic changes will not provide the real jobs necessary to employ the structurally unemployed regardless of their age.

A national commitment is necessary to aid the hard-to-employ. This commitment must not be limited to just Government and business but instead must include business, Government, labor, educational institutions, churches, civic organizations and many of the others in the social spectrum of our society.

Only by this type of massive commitment can we truly solve this complicated and unfortunately growing problem.

Probably the best reason for our commitment to fight structural unemployment is that the problem most seriously affects the young and minorities, two groups who, by and large, have not participated in America's dream historically.

Besides the blacks and the teenagers we have a problem of structural unemployment with women, who after a long absence from the labor market find it very difficult to get jobs.

Indeed, our efforts to solve this problem may determine, more than most people know, whether the American dream is real or not, whether we can in effect develop the kind of society that most of us think we now live in because we are part of the work force.

I welcome the witnesses here today in helping this committee and this country determine how to best mobilize our efforts to solve this severe problem.

I introduced legislation that takes the private sector targeted training subsidy approach but I am fully aware of specific advantages of some public sector programs in dealing with this problem and I am looking forward to hearing any other ideas that our panel or others may have.

I welcome your views on how our commitment should be shaped. Thank you, Congressman Mitchell.

Representative Mitchell. What I would like to propose is that we hear from our first two witnesses, then go into questions, and then hear from our last two witnesses, unless there is some objection from the panel.

If not, fine.

Mr. Nichols, we are delighted that you could be here with us. We have a copy of your prepared statement before us and we have had an opportunity to review it.

You have the option of presenting your prepared statement in its entirety or abstracting therefrom. It is entirely up to you.

## STATEMENT OF HON. DONALD A. NICHOLS, DEPUTY ASSISTANT SECRETARY, ECONOMIC POLICY AND RESEARCH, DEPARTMENT OF LABOR

Mr. Nichols. Thank you Congressman Mitchell.

I will just give you the general picture that is in that testimony and submit the prepared statement for the record.

Representative Mitchell. That will be fine.

You are going to have to project your voice quite a bit.

Mr. Nichols. I do have an appendix that was not attached to what I submitted yesterday and I would like that to be placed in the record as well. However, some numbers are missing from these copies and I will submit them later, if that is all right.

Representative Mitchell. Fine.

It will be placed in the hearing record.

Mr. Nichols. I appreciate the opportunity to appear before you and discuss the role that structural employment programs can play in reducing the overall unemployment rate.

Let me say at the outset that I do think there is a major role for these programs to play. I am optimistic about this on several counts.

I am optimistic that we are putting together an intellectual framework that will permit us to analyze this problem in a quantitative way. To date, we have not been able to determine in an overall way the appropriate role for our structural programs to play, but I think major progress has been made this year.

Second, I am an optimist as to what the early numbers reveal from using this framework in a very preliminary way. The numbers I will present today are certainly preliminary, certainly tentative.

I have resisted the temptation to give you aggregate statistics as to what I think could be done to the unemployment rate through structural means because these numbers are so preliminary, but I do think they support an optimistic view of what can be done in the future.

The problem is indeed complicated, as Congressman Brown said, and so complicated that I think it is fair to say analyses to date have not served us well in terms of giving us a fair description of the role of overall structural programs.

The major new direction taken this year was due to two Yale professors, Martin Baily and James Tobin, who presented a paper which linked overall unemployment rates of several different kinds to the inflation rate. Now the basic idea behind their framework is that it is appropriate for policymakers to do what we can do in reducing unemployment through aggregate means—through monetary and fiscal policies—but that an inflation barrier is eventually encountered and that prevents unemployment from being reduced, as you said in your opening remarks.

Baily and Tobin break the labor force up into several groups according to industry and link these unemployment rates to inflation using historical data.

They find a tighter link between the unemployment rates for certain industries which have highly skilled workers than for others and this indicates that it should be possible to reduce unemployment rates for the low-skilled industries without making the inflation problem any worse.

The labor force can be broken up in several ways: By industry—and my colleagues here today have dealt with demographic breakdowns—by age, race, and sex.

What I will report on is a breakdown by occupation that I have done. Regardless of which of these breakdowns is used the general approach is to attempt to get at a breakdown that separates the groups in the population which have structural problems from the others.

Now, the data are such that we cannot find a perfect breakdown between who have structural problems and those who do not. We can only approximate this and this fact makes it very difficult to do the analytic work.

We can look at the demographic unemployment rates. As you say, the black teenage rate we see is much higher than the other unemployment rates and this indicates that black teenagers have structural problems to a more severe extent than other groups do.

However, there are admittedly some black teenagers who are doing quite well in the labor force.

Alternatively, we can break it down by industries and say that many workers in certain industries appear to be doing well or we could break it, as I have done, by occupation and we find that unemployment rates of certain groups are indeed much higher than they are in the higher skilled occupations.

The breakdown I give is not a perfect one; it is an attempt to get the labor force into two groups—one with structural problems, one without—but that attempt, I think, will never be successful because of the nature of the structural unemployment problem.

I think for every worker the structural problems, cyclical problems and seasonal problems are difficult to disentangle. Cyclical, structural, frictional or seasonal are the four categories we usually use to classify the problems that cause unemployment and I think they are useful for classifying these causes and therefore even for classifying the cures for unemployment, but they are not useful for classifying the unemployed workers themselves.

You simply cannot say that a particular person is unemployed for structural reasons alone and one reason is because the structural elements are commingled with cyclical and frictional factors. That is what makes the analytic work so difficult and why we have had trouble to date in coming up with overall approaches to this problem.

What I have done is to break the labor force roughly in half—into those occupations that have the wage rates above average and those in occupations with wage rates below average. The groupings are quite crude. I know there are many high-wage workers in low-wage occupations and vice versa. Nevertheless, the breakdown is such that on average the high-wage occupations have an income roughly double that of the low-wage ones.

My findings confirm the general Baily-Tobin idea. I looked historically at the relation between the unemployment rates of these two groups and the rate of inflation. I find little influence of changes in the unemployment of the low-skilled group on inflation. This would support the general finding that structural programs can be used to reduce the unemployment rates of low-skilled workers without increasing the rate of inflation.

On the other hand, I do find that the unemployment rate of high wage occupation groups affects inflation and this is what makes it so difficult to reduce the unemployment rate through overall monetary and fiscal policies. As the unemployment rate declines, we run into shortages of certain high-skilled workers. Increased demand then leads to wage increases rather than employment increases. This puts pressure on costs and inflation results.

This gives us a second role for structural programs. Structural programs not only can be used to increase employment through public service employment, for example, of low-skilled groups, but to transform these lower skilled workers into higher skilled workers, thereby eliminating bottlenecks and shortages that ultimately lead to wage increases.

While I have only broken the labor force into two very crude groups in my analysis—and I can't pretend that a structural program would take the average worker from the lower group and put him in the higher group—I use these results as an indication of what structural programs can do by increasing the skills that workers have.

Another finding I came up with is that the low-wage labor force appears to be quite elastic. I had intended or desired to take this result about the effect of unemployment rates on inflation to look at what happens when you increase unemployment through overall aggregate measures and what would happen if you did it through structural measures. I was unable to finish that for a variety of reasons but what I found as part of the work toward this goal was that when there is an increase in employment in these low-wage occupations, the jobs that are created tend to go to workers who are not in the labor force.

Out of every 10 additional jobs in the low-wage labor market, in the past 7 were taken by workers not in the labor force and 3 by workers counted as unemployed.

That would say that in general to reduce measured unemployment rates by increasing the employment in low-wage occupations would require almost a 3-for-1 ratio—three jobs created for every one unemployed worker that is hired.

Now, that, I say, is in general. This relationship comes from average historical relations; it ignores the possibility for targeting of the kind that we now have in CETA, which can make the batting average a little better. That is, in CETA we give preference to workers who have been unemployed a long period of time. Hiring these workers would reduce unemployment. Furthermore, by targeting on family income, we probably tend to hire the worker in the family who would be listed as being officially unemployed. I have not checked the data on this latter possibility. I can only say that the overall number I report is more pessimistic than what could be achieved with proper targeting and I suspect that a number far better than 3 out of 10 can be attained. But I have no results to report to you on this.

I do submit, however, that what I call this elasticity of the low-wage labor force indicates that there are a large number of workers willing to work in jobs if they are available. A large number of hidden unemployed workers exist who would take jobs in these low-paid jobs if they are available. We should not ignore this even if the employment of these workers doesn't help us reduce the reported unemployment rate—the measure by which we sometimes grade ourselves.

This result, I think should be interpreted more as casting doubt on the measure itself rather than on the usefulness of the structural programs in reducing unemployment.

The work that Baily-Tobin did generally confirms the results I found. I think there is a role for structural programs to play.

I think we are getting an analytic framework that would allow us to put numbers on the size of this role but the work is so very recent so the results I report to you should be interpreted as tentative.

I would be irresponsible if I said that national policy should be based on these numbers as new and untested as they are. I can tell you that further research is being done and I think the progress made this year indicates that we are going to know shortly what can be done with structural programs.

Thank you.

Representative MITCHELL. Thank you, Mr. Nichols.

[The prepared statement of Mr. Nichols, together with a technical appendix, follows:]

## PREPARED STATEMENT OF HON. DONALD A. NICHOLS

### SUMMARY

Historical data indicate that increases in employment in low wage occupations have little effect on the inflation rate. This supports the conclusion that structural programs can increase employment without increasing inflation.

The data also indicate that inflation increases when unemployment in high wage occupations declines. This supports the conclusion that structural programs to upgrade low wage workers can reduce inflationary pressures, thereby permitting employment to grow without increasing inflation.

The low wage labor force appears to be quite elastic. Historically, 70 percent of the increases in employment in low wage occupations have been associated with increases in the labor force, not with reductions in unemployment. This means that untargeted PSE programs will have a small effect on reported unemployment rates. No tests were performed on targeting restrictions but it appears that proper targeting—of the form now required in CETA—can increase substantially the effect of PSE on reported unemployment.

The elasticity of the low wage labor force indicates the existence of a large body of potential workers not counted as unemployed. The needs of this group should be considered even if proposals to address them do not have a substantial effect on reported unemployment rates.

The framework used in this paper for analyzing structural unemployment is that described by Baily and Tobin wherein the role of structural programs is determined simultaneously with the role of cyclical or stabilization policies. It appears to be a fruitful way of analyzing the overall role structural programs can play in reducing unemployment in a noninflationary way.

Finally, structural unemployment is extremely difficult to measure. There are problems of separating structural factors from seasonal, cyclical and frictional factors; there are errors in measuring structural factors; and there is an essentially arbitrary decision that must be made about how severe an employment problem must be to classify an individual as structurally unemployed. Analyses using estimates of structural employment are therefore often inconclusive. The Baily-Tobin framework, however, does not require a precise numerical estimate of the size of the problem in order to be of use.

### PROBLEMS IN DEFINING STRUCTURAL UNEMPLOYMENT

There does not exist today a satisfactory way to analyze, define or measure structural unemployment. Nor is one likely to exist in the near future. Three basic problems are responsible for this situation.

First is that the classification of unemployment into cyclical, structural, frictional or seasonal components may be useful when thinking about the causes—and therefore the cures—of unemployment, but is not useful as a way to classify specific unemployed workers. Any workable classification of individuals as structurally unemployed—for example, those unemployed for more than 15 consecutive weeks—will be flawed in principle by the fact that it is not independent of seasonal and cyclical factors.

While those unemployed 15 weeks or more will tend to be those facing severe employment problems, and in my opinion will tend to be those who could profit from Government programs for the structurally unemployed, the number of workers in this category grows and falls with the business cycle and the seasons of the year just as the total number of unemployed does. At any point in time there will be many highly educated individuals and many high wage workers who have been unemployed 15 weeks or more. They will not be typical of the workers in that category but they will be there.

The point is that there are usually a combination of forces—cyclical, structural, seasonal and frictional—to blame for the fact that a particular worker is unemployed. In some workers the structural forces will be more important than others but it is impossible to create categories of workers who are unemployed exclusively for structural, cyclical, frictional or seasonal reasons.

This does not mean there is not a problem of structural unemployment. Workers without skills, education or experience living in areas where few jobs exist face job-finding difficulties that are an order of magnitude larger than the employment problems ever faced by anyone in this room. Structural unemployment exists. But to date it has defied our attempts to measure it in isolation from other forms of unemployment. And without a uniformly recognized estimate of the number of unemployed workers, it is difficult to prescribe role for structural programs.

The second major problem in defining the structurally unemployed is that the structural characteristics of workers generally differ from each other by matters of degree rather than by the distinct presence or absence of a particular trait that makes employment more or less likely. The level of schooling or training, for example, varies continuously over the range of interest, and a decision that a worker with 11.5 years of schooling is deprived while one with 12 is not is basically arbitrary. If we were to rank workers and place them on a ladder with the most employable near the top and the least employable near the bottom there would be no way to draw a line separating them into two distinct homogeneous groups, one having structural problems and the other not. Clearly the worker at the bottom would need help while the one at the top would not, but those near the arbitrary line would be much like each other whether they were above or below the line. In this situation it is very difficult to get agreement on where the line should be drawn.

An indication of the fact that structural problems are a matter of degree is that most workers with structural problems are employed. Most of them have low wage unskilled jobs and may well become unemployed at some time in the future, but at any point in time the majority of these workers are employed. This means analyses of structural problems should not be restricted to unemployed workers but should include the whole low wage labor force.

The third problem in measuring and defining structural unemployment is that the measures themselves are not precise. A high school education, for example, means many different things. Skill training is hard enough to quantify within occupational groups, but almost impossible to compare across groups. Innate abilities, attitudes toward employment and employers, and knowledge of what it takes to succeed will never be measured perfectly. This means that whatever the set of indicators we choose by which to classify a workers as having structural problems, it will be subject to a large amount of error.

In summary, it is hard to come up with a good measure of structural unemployment because the structural characteristics of workers are measured imprecisely, because they vary by degree, and because they are commingled with cyclical, frictional and seasonal factors to a varying extent in each unemployed worker. Because of these measurement and definitional problems, quantitative analyses of the overall problem of structural unemployment are exceedingly difficult. The studies that have been completed generally admit that they cover only part of the problem. To link the parts together into an overall framework would be a major undertaking.

## AN OVERALL FRAMEWORK OF ANALYSIS

Frameworks have been suggested, however, that rely on the data available from existing labor force classifications. The one I will use here was recently suggested by Baily and Tobin.[1] In a single framework they determine simultaneously the roles for countercyclical and structural policies. The roles depend importantly on the effect of the policies on inflation.

They argue that the ability to reduce the overall unemployment rate through economic growth is limited by inflation. It doesn't matter whether one views this limitation as political or economic. Inflation poses a barrier to the lessening of unemployment with macro-economic policies.

When the lowest unemployment rate consistent with the inflation barrier is reached, the unemployment rate of low skilled workers will still be high and will be substantially higher than that of high skilled workers. Shortages of low skilled workers will be rare and a reduction in the unemployment rate of this group by itself would not cause inflation to increase. The high skilled group, on the other hand, will have shortages and an attempt to reduce their unemployment rate further would tend to lead to wage increases rather than to employment increases. Therefore, an attempt to reduce unemployment among the low skilled by increasing economic activity is stymied by the fact that it will lead to shortages in the high skilled market and therefore to inflation.

The role of structural programs is then clear. They should attempt to increase the demand for low skilled workers without increasing demand for high skilled workers, and they should try to upgrade some workers from the low skilled occupations into the higher skilled ones. Public service employment is an example of a change in the demand for low skilled workers, while training is an example of upgrading. PSE, of course, can lead to upgrading too as the workers gain experience.

Baily and Tobin limited themselves to two groups of workers for purposes of exposition. In principle, upgrading can take place along a continuum and PSE can encompass a variety of skills. But the overall framework they suggest is a useful one. Because of inflation, there is only so much we can do to reduce unemployment through overall monetary and fiscal policies. Further reductions require that employment be increased only for the groups not likely to have an effect on inflation, or that the supply of workers be increased in the groups most likely to affect inflation.

This framework offers promise. It is possible to use it, for example, without having a precise measure of the number of structurally unemployed workers. What is necessary is to break the labor force into a hierarchy of groups and to determine the effect of the employment of these groups on the inflation rate. From those estimates the agenda for structural policies will emerge.

## A PRELIMINARY ANALYSIS OF THE ROLE OF STRUCTURAL PROGRAMS

The analysis reported here uses but one of many possible classifications of workers. Following Baily and Tobin we classified workers in two groups each of which contained several occupations. High wage occupations were grouped together as were low wage ones according to the classification shown in Table 1.

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[1] Martin Baily and James Tobin, "Inflation-Unemployment Consequences of Job Creation Policies," in John Palmer ed. Creating Jobs: Public Employment Programs and Wage Subsidies, Brookings, 1978.

TABLE 1.—CLASSIFICATION OF HIGH-WAGE AND LOW-WAGE OCCUPATIONS

| Occupation | 1978 employment (thousands) | 1978 unemployment (thousands) | 1978 unemployment rate (percent) | Median wage rate, May 1978 |
|---|---|---|---|---|
| High-wage group: | | | | |
| Managers and administ[illegible]s | 10, 105 | 214 | 2.1 | $6.87 |
| Professional and techn[illegible]orkers | 14, 245 | 381 | 2.6 | 6.74 |
| Craft and kindred workers | 12, 386 | 603 | 4.6 | 6.50 |
| Transport operatives | 14, 416 | 1, 155 | 7.4 | 5.36 |
| Operatives excluding transport | | | | 4.47 |
| Total | 51, 152 | 2, 353 | 4.4 | |
| Low-wage group: | | | | |
| Clerical workers | 16, 904 | 866 | 4.9 | 4.17 |
| Nonfarm laborers | 4, 729 | 566 | 10.7 | 4.11 |
| Sales workers | 5, 951 | 256 | 4.1 | 3.85 |
| Other service workers | 11, 677 | 966 | 7.6 | 3.20 |
| Farm workers | 2, 798 | 110 | 3.8 | 2.77 |
| Private household workers | 1, 162 | 63 | 5.1 | 2.04 |
| No previous work experience | | 868 | | |
| Total | 43, 221 | 3, 695 | 7.9 | |

Because this classification is crude the results of this study should be interpreted as an illustration rather than as a refined set of estimates. Nevertheless, I find the results interesting. Using conventional statistical techniques, it was found that indeed the unemployment rate of the high wage occupations had an important effect on the inflation rate while the unemployment rate of low wage workers had little effect.

A variety of specific forms for this statistical relationship were examined and virtually all reached the same conclusion. The statistical tests are reported in an Appendix.

This indicates that programs that reduce the low wage unemployment rate will not add significantly to inflationary pressures unless they also reduce the high wage unemployment rate. The potential role for structural programs is therefore quite large. With proper elibigility requirements PSE programs can be restricted to those who would normally work in the low wage market and therefore, would not add to inflation.

Furthermore, programs that upgrade worker qualifications can also reduce inflationary pressures. By increasing the pool of workers in high wage occupations, the high wage unemployment rate grows relative to the low wage rate. The data indicate this would lead to lower average wage increases, and therefore permit a higher rate of unemployment for the same rate of wage increase. Work experience on PSE, training and education can all upgrade worker qualifications. These results suggest there is an important role for structural programs to play in reducing unemployment in non-inflationary ways.

On the other hand, it was found that the low wage labor force is quite elastic. Increases in overall low wage employment have generally been associated with increases in the low wage labor force and not with reductions in reported unemployment. This means that untargetted increases in low wage employment would have little effect on the reported unemployment rate. The statistical tests of these relations are also found in the Appendix. They indicate that for every 10 new low wage jobs created in the entire economy, 7 are taken by people not in the labor force while 3 are taken by unemployed workers.

I would like to emphasize that these numbers do not refer to jobs created under the existing CETA program. The eligibility requirements of that program make these general estimates inappropriate. The general estimates are for low wage jobs of all kinds, public and private. The estimates indicate, however, the way in which targetting requirements can affect the impact of a PSE program on the unemployment rate. For example, preference for PSE jobs could be given to workers previously registered as unemployed. This would cause a larger decline in reported unemployment than a program without this restriction, but the reduction would still not be one for one because of slippage. First, workers not in the the labor force could register for work simply to satisfy the eligibility requirement in order to qualify for a PSE job. Second, unemployed workers might take PSE jobs instead of other jobs and allow these other jobs to be taken by new entrants.

A second way to target—now reflected in the CETA legislation and in the Administration's welfare reform proposal—is by family income. This tends to restrict PSE jobs to families without any other employment. I have not checked, but I suspect that the labor force participation of family heads is far higher than for other workers and that the majority of the family heads who would take PSE jobs would already be registered as unemployed.

I conclude that while the targetting issue needs further analysis it is likely that the effect of PSE on reported unemployment is substantially affected by eligibility requirements. With proper requirements PSE can have a substantial effect on unemployment without causing inflation to increase.

The analysis raises an important further question, however. If a substantial portion of the workers who take low wage jobs are not previously counted as unemployed, the group desiring jobs is larger than the unemployment statistics indicate. There is an important role for structural programs to play in meeting these needs even if the effect of the programs on the reported unemployment rate is modest. With current budget problems, it is unlikely these needs can be met so it is wise to continue the trend Congress and the Administration have followed in strengthening eligibility requirements. Not only does this direct the jobs to those most in need—which is what the targetting requirements are intended to do—but it also has the effect of reducing the reported unemployment rate the most—which is the issue to which this testimony is addressed. I simply point out the elastic nature of the low wage labor force and the potential for a substantial increase in employment in that group without adding to inflation.

## FURTHER RESEARCH

The results described here illustrate the usefulness of the Baily-Tobin framework. While finer divisions of the labor force are possible and will presumably lead to more precise estimates than the ones presented here, the results are encouraging both to the usefulness of the framework and to the possibility of using structural programs to solve the unemployment problem.

Further research must consider a variety of possible labor force classifications not considered here. Classifications corresponding to existing eligibility requirements should be constructed, where possible, so the effects of existing programs can be determined.

## *Technical Appendix*[1]

### *Data*

The CPS classifies workers by occupation. Major occupational groups were ranked according to their wage rate in the May 1978 CPS. The labor force was then divided roughly in half with the highest wage occupations in one half and the lowest in the other. New entrants to the labor force were included in the low wage occupation group. Quarterly data from 1958 for employment and unemployment in each group were used for the statistical tests reported here. The occupational groups are shown in Table 1.

Wage rates to match the employment classifications are not available from the CPS on a quarterly basis. It is impossible to construct a wage series that would apply to these classifications. Because of this an aggregate wage index was used and indicators of employment or unemployment in the two markets were entered independently into the same regression to determine their impact on the overall wage rate. The average hourly earning index was used to measure the rate of wage change.

### *Econometric Estimates—Wage Equations*

Various relationships were tried though only a few are reported here.

When the percentage wage change was used as the dependent variable, the sum of the coefficients on the lagged dependent variables was 1.03. Therefore the equations reported here are estimated in the accelerationist form. The lag structure imposed on the dependent variable is close to that estimated except that the weights are constrained to sum to one: A weight of —.7 is given to the rate of wage change over the previous four quarters and a weight of —.3 on the rate of change over the two years before that.

The following is a typical regression.

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[1] The statistical work was performed by Constance Schnabel who also suggested many of the tests that were performed. I thank her for her excellent work.

REGRESSION 1

[Quarterly (1958:1 to 1978:4); 84 observations; dependent variable: DDW]

| Independent variable | Coefficient | Standard error | T-stat |
|---|---|---|---|
| Constant | −0.702400 | 0.6012 | −1.168 |
| ALTPI (1) | 2.64175 | .7419 | 3.561 |
| DX (2) | .0212657 | .004108 | 5.177 |
| IRUHP (3) | .0784135 | .03389 | 2.314 |
| IRULR (4) | −.0813642 | .087[illegible] | −.9327 |

Note: R-bar squared: 0.4123; Durbin–Watson statistic: 1.8215; standard error of the recr[illegible] 0.8277; normalized: 5.[illegible]70.

*Variable Names*

DW = % change in Hourly Earnings Index expressed as an annual rate
DDW = Acceleration in Hourly Earnings Index DW − .7 (Average of 4 preceding DWs) − .3 (average of 8 preceding DWs)
ALTPL = Guidepost Dummy
DX = Minimum Wage
IRUHR = Inverse of Unemployment Rate of High Wage Occupations
IRULR = Inverse of Unemployment Rate of Low Wage Occupations

Note that the inverse of the high wage unemployment rate is statistically significant in regression 1 while the low wage rate is not. In this regression, the low wage unemployment rate has the wrong sign, a phenomenon that was typical of the regressions run.

When the low wage unemployment rate is dropped from the regression, a better estimate of the coefficient on the high wage unemployment rate results and its statistical significance improves.

REGRESSION 2

[Quarterly (1958:1 to 1978:4); 84 observations; dependent variable: DDW]

| Independent variable | Coefficient | Standard error | T-stat |
|---|---|---|---|
| Constant | −1.18476 | 0.3045 | −3.894 |
| ALTP1 (1) | 2.65737 | .7411 | 3.586 |
| DX (2) | .0216794 | .004080 | 5.313 |
| IRUNR (3) | .0486872 | .01152 | 4.225 |

Note: R-bar squared: 0.4132; Durbin-Watson statistic: 1.7932; standard error of the regression: 0.8271; normalize: 5.166.

When the low wage rate is used by itself its coefficient is also significant with the right sign. This indicates that its insignificance in the first regression is due to the presence of multicollinearity. The correlation between the two unemployment rates is .79.

REGRESSION 3

[Quarterly (1958:1 to 1978:4); 84 observations; dependent variable: DDW]

| Independent variable | Coefficient | Standard error | T-stat |
|---|---|---|---|
| Constant | −1.60151 | 0.4710 | −3.400 |
| ALTP1 (1) | 2.69809 | .7614 | 3.543 |
| DX (2) | .0222924 | .004193 | 5.316 |
| IRULR (3) | .108408 | .03048 | 3.557 |

Note: R-bar squared: 0.3803; Durin-Watson statistic: 1.7070; standard error of the regression: 0.8500; normalized: 5.309.

Because the unemployment of low wage workers seems to behave erratically, an employment rate was constructed and its effect on wage rates was estimated. This rate was constructed by generating an estimate of the normal labor force in high and low wage occupations by regressing the actual labor forces on time. The predicted values expressed as fourth order polynomials of time were then used to deflate the employment statistics. For purposes of comparability these employment rates were subtracted from one and entered as unemployment rates in the next regression reported. It would be noted that all the variations in these variables are in employment rates and not in unemployment.

In regression 4, we see that when expressed in the employment form, both variables acquire the expected sign. Again, however, only the high wage unemployment rate has a statistically significant coefficient. In this relation the orders of magnitude of the coefficients are appealing to me as well since the much smaller mean of the universe of the low wage unemployment rate indicates a much lower rate of wage increase would result from a change in low wage employment than from an equal change in high wage employment.

**REGRESSION 4**

[Quarterly (1958:1 to 1978:4); 84 observations; dependent variable: DDW]

| Independent variable | Coefficient | Standard error | T-stat |
|---|---|---|---|
| Constant | −1.03578 | 0.4583 | −2.260 |
| ALTPL (1) | 2.63502 | .7607 | 3.464 |
| DX (2) | .0210418 | .004306 | 4.887 |
| IRUHY (3) | .0282334 | .01107 | 2.551 |
| IRULY (4) | .0219081 | .03691 | .5935 |

Note: R-bar squared: 0.3835; Durbin-Watson statistic: 1.7882; standard-error of the regression: 0.8478; normalized: 5.295.

Regressions with the overall unemployment rate were also tried, but the overall rate would lose statistical significance when entered simultaneously with the high wage unemployment rate, though the latter rate would occasionally attain significance in these relations.

When the aggregate unemployment rate was entered with a ratio of employment in the two sets of occupations, the ratio variable would enter in a statistically significant manner and the unemployment rate would not.

The conclusion is that the rate of wage change is much more strongly affected by the rate of unemployment in high wage occupations than in low wage ones. This confirms the results of Baily and Tobin who dealt with industrial data rather than occupational data.

*Econometric Estimates—Labor Force Participation Equations*

Economists are accustomed to the fact that the estimated labor force increases when employment increases. Of every 10 new jobs created, it is traditionally thought that roughly 6 are taken by unemployed workers and 4 by workers not previously counted as being in the labor force.

Here I report how participation is affected by changes in employment in high and low wage occupations. While the total of these relationships is very close to the traditional relation, the parts show a wide divergence.

All of the employment and labor force variables in the reported regressions have been deflated by an estimate of the trend growth in the labor force. This is a sum of the separate fourth order polynomials of high and low wage labor forces used in some of the wage equations.

*Participation Estimates*

Regressions 5 and 6

$$\Delta LH = .00003 + \underset{(11.1)}{.478\,\Delta EH} - \underset{(-3.6)}{.183\,\Delta EL}$$

$R^{-2} = 6.2$
D.W. $= 1.68$
S.E. $= .0014$

$$\Delta LL = .001 - \underset{(-10.1)}{.385\,\Delta EH} + \underset{(18.6)}{.880\,\Delta EL}$$

$R^{-2} = .839$
$\rho = -.219\ (-1.94)$
D.W. $= 2.01$
S.E. $= .0013$

$\Delta LH$ = Change in high wage labor force.
$\Delta LL$ = Change in low wage labor force.
$\Delta EH$ = Change in high wage employment.
$\Delta EL$ = Change in low wage employment.
$\rho$ = Cochrane-Orcutt autocorrelation correction.

These regressions tell us that of every 100 new jobs created in high wage occupations 52 will be taken by unemployed workers in high wage occupations, 39 by unemployed workers in low wage occupations and 9 by workers not in the labor force.

Of every 100 jobs created in low wage occupations 18 will be taken by unemployed workers in high wage occupations, 12 by unemployed workers in low wage occupations and 70 by workers not in the labor force.

Representative MITCHELL. As we previously agreed to, we will turn to Mr. Johnson as our next witness.

Mr. George E. Johnson is currently professor of economics at the University of Michigan. I believe you have been with that faculty since 1966.

Mr. Johnson has served as a Senior Staff Economist with the Council of Economic Advisers. He has also served as Director of the Office of Evaluation and Research for the Department of Labor.

We welcome you and we are anxious to hear your testimony.

## STATEMENT OF GEORGE E. JOHNSON, PROFESSOR OF ECONOMICS, UNIVERSITY OF MICHIGAN

Mr. JOHNSON. Thank you very much, Congressman Mitchell.

The two questions posed by the committee really are interrelated. They are really the same question because it is only by reducing the unemployment rates of certain target groups, certain groups with the most serious problems, that we can reduce the overall unemployment rate consistent with nonaccelerating inflation, so they really are the same question.

The major point of my prepared statement is that employment and training programs can have a large and significant impact on unemployment if they are targeted toward those groups in the labor force whose labor markets can be described as rigid as opposed to flexible.

Now, by rigid and flexible, it gets to be a very complicated point and the meaning is very much consistent with the view that Mr. Nichols has just expressed.

The opposite of rigidity is, of course, flexibility and in that situation if the programs are targeted toward individuals who are in labor markets where there is a great deal of adjustment, then, for example, an employment program that gives PSE jobs to individuals in a flexible labor market will merely attract them away from the private sector and raise their wages.

It is a very complicated problem to try to determine the extent of rigidity in the labor market. It is a complicated issue for the major reason that Mr. Nichols suggested, specifically that the data are just simply not there so that we can identify those workers who are structurally unemployed; that is, those in rigid labor markets as opposed to those who are more or less fully employed.

My own research, I am afraid, yields more pessimistic conclusions than that research just reported by Don Nichols.

I have concluded that most labor markets in the United States are characterized by a great deal of flexibility and that a large expansion of our current employment and training programs will have only a small effect on the potential unemployment rate; that is, the unemployment rate consistent with nonaccelerating inflation—but I do not think that it is realistic on the basis of available evidence to assert that they could have a major impact.

Now, there are some very major and significant exceptions to this conclusion and that is principally the case of minority youth.

There is no question in my mind but that if we were to eliminate the roughly 250,000 work experience jobs under YEDPA and the other CETA programs the unemployment rates of minority youth would be even higher or, even more importantly, their total employment relative to their population would fall.

This is the area where I think labor market programs have had their major impact on a proportionate basis; it is the most serious social problem having to do with labor markets in our society and the programs cannot be faulted at the present time for being undertargeted toward minority youth.

However, I think it is there that the major potential for reducing overall unemployment exists.

There are a couple of additional points that I would like to make, only one of which I developed in my prepared statement.

The question of whether or not labor market policy can in theory lower structural unemployment is one matter. It is the question on the floor today, but an equally relevant question is how one sets up a coherent national labor market policy.

I do believe that to the extent that the Congress and the administration are serious about making a major impact on structural unemployment that there have to be some rather significant changes in the organization of our employment and training programs.

It is not the major topic today but it is necessary to refederalize these programs because basically poverty and structural unemployment are national problems.

You could not solve the problem of poverty and structural unemployment in Detroit or Newark or Baltimore or Peoria in isolation mainly because there is a great deal of mobility of people within this country.

It is a national problem and there has to be, I think, a lot more coordination of our efforts to reduce poverty and structural unemployment from the Federal level rather than to have a decentralized revenue sharing approach.

The second point is how optimistic or pessimistic we can be. A factor that has not received very much attention is the problem of immigration into the United States.

During the last 10 years we have had a very large spate of immigration of low-skilled labor into the United States, and that is now spreading throughout the country.

There is no question in my mind that this has had a significant impact on the earnings and the employment of the domestic population at the low end of the skill distribution.

To the extent that this rate of immigration continues in the future, the problems of the low-skilled domestic population are going to get worse, and I am afraid that our labor market policies have got to start taking this into account.

In terms of what we can expect to happen, we really would be doing quite well if the labor market programs helped keep us where we are now as opposed to any notions of really improving the situation above where we are now.

In summary, I would like to be able to conclude, like Don Nichols, that I am optimistic about our prospects for reducing unemployment, but I am afraid I cannot honestly do that.

Representative MITCHELL. Thank you very much, Mr. Johnson.
[The prepared statement of Mr. Johnson follows:]

## PREPARED STATEMENT OF GEORGE E. JOHNSON

### *Structural Employment and Training Programs: Their Impact on Unemployment*

Mr. Chairman and members of the committee, there are three important sets of questions about the impact of our labor market programs on unemployment:

(a) Can they lower the unemployment rates of those groups that have the highest incidence of unemployment?

(b) To what extent can labor market programs lower the overall unemployment rate consistent with non-accelerating inflation?

(c) What level of resources must be committed to lower the unemployment rate consistent with non-accelerating inflation by a specified amount?

To summarize my answers to these questions:

(a) Probably yes.

(b) Not very much.

(c) To lower the non-inflationary unemployment rate by as much as one percentage point, the budget for these programs would have to be increased many-fold—perhaps to as high as $100 billion per year.

It must, however, be pointed out that any economist's answers to these questions are subject to a wide margin of error. The reasons for this uncertainty are two-fold:

(1) There is no consensus on the question of how low-wage labor markets operate. For example, there is no definitive treatment of the question of why the unemployment rate of minority teenagers is so high and has been rising over the past 20 years. There are several lists of possible explanations, but we simply don't know which combination of factors have accounted for what has happened.

(2) There is also virtually no hard information concerning the degree to which specific programmatic approaches that have been used in the past have been successful. In part, this absence of impact evaluation information is due to the fact that—as is true throughout the Federal government—the responsibility for evaluating programs is vested in the agencies that run the programs; they are understandably more interested in learning how to improve their programs than in helping OMB and the Congress decide whether or not they should be continued. In part, however, our ignorance about the impact of past programs is a reflection of the poor state of knowledge about how the relevant labor markets operate; evaluation questions cannot be formulated in a vacum.

### I. *The Structure of Unemployment*

Before considering the potential impact of labor market programs on the unemployment rates of specific groups in the labor force, it is useful to review what has been happening to the structure of unemployment during this decade.

Table 1 shows unemployment rates for different race-age-sex groups for four separate years in the 1970's. The most striking feature of the table is the marked deterioration of the relative employment situation of minorities.

TABLE 1.—UNEMPLOYMENT RATES BY RACE. AGE, AND SEX FOR SELECTED YEARS IN THE 1970's

| | 1970 | | 1973 | | 1977 | | 1978 | |
|---|---|---|---|---|---|---|---|---|
| Age | White | Black and other | White | Black and other | White | Black and other | White | Black and other |
| 16 to 19: | | | | | | | | |
| Male | 13.7 | 24.9 | 12.3 | 26.9 | 15.0 | 37.0 | 13.5 | 34.4 |
| Female | 13.3 | 34.4 | 13.0 | 34.5 | 15.9 | 39.9 | 14.4 | 38.4 |
| 20 to 24: | | | | | | | | |
| Male | 7.8 | 12.6 | 6.5 | 12.6 | 9.3 | 21.7 | 7.6 | 20.0 |
| Female | 6.9 | 15.0 | 7.0 | 17.6 | 9.3 | 23.6 | 8.3 | 21.3 |
| 25 and over: | | | | | | | | |
| Male | 2.6 | 4.4 | 2.4 | 4.2 | 3.8 | 7.7 | 3.1 | 6.4 |
| Female | 3.9 | 5.2 | 3.7 | 6.1 | 5.5 | 9.1 | 4.5 | 8.2 |
| Total | 4.9 | | 4.9 | | 7.0 | | 6.0 | |

Source: Bureau of Labor Statistics, "Employment and Earnings for 1970, 1973, and 1977," unpublished Bureau of Labor Statistics data for 1978.

Whereas the 1978 unemployment rates of adult whites (age 25+) are less than one percentage point higher than their 1970 and 1973 values, the unemployment rates of black adults are two to three percentage points higher.

The unemployment rates of younger whites (ages 16–19 and 20–24) are also not much higher than in 1970 and 1973, but the unemployment rates of black youth have skyrocketed. Moreover, the published unemployment rates understate the severity of these changes, for the labor force participation rates of minority youth have fallen since 1970 while the participation rates for white youth have risen. Thus, for example, at the present time the ratio of employment to population is almost twice as great for white teenagers as for black teenagers.

Although unemployment is by no means exclusively a problem faced only by minorities (indeed, 75 percent of the unemployed in 1978 were white), the high and increasing relative unemployment rates of blacks explains to a large extent why the overall rate of unemployment in 1978 was so high.

If the unemployment rates of the black sex-age groups in Table 1 were equal to their white equivalents, the 1978 overall unemployment rate would have been 0.8 percentage points lower. In other words, racial differences in unemployment rates by sex and age account for 40 percent of the gap between the actual 1978 unemployment rate of six percent and the recently-established national objective of four percent.

Since there are still significant differences between blacks and whites in characteristics that explain the incidence of unemployment (for example, educational attainment and residence in urban areas), it would be unreasonable to expect that unemployment rates by age and sex would be identical for blacks and whites. However, much of the disadvantage in the relative employment situation of minorities has occurred since 1970. If, in fact, the 1978 unemployment rates by age and sex for blacks were in the same proportion to the equivalent rates for whites as they were in 1970, the overall unemployment rate would have been 0.35 percentage points lower than it was, or between 5.6 and 5.7 percent.

The performance of the labor market in the U.S. during the 1970's has, with the significant exception of the worsening relative employment situation of minorities, been quite good.

Because of blips in the age structure and the increasing labor force activity of women, the labor force of young persons and women increased markedly relative to the labor force of adult men. In an economy characterized by relative wage rigidity and severe structural unemployment, this would have meant large increases in the unemployment rates of these rapidly growing groups. But, again with the exception of minorities (especially minority youth), this did not happen; instead, the distribution of employment adjusted quite well to the changed distribution of the labor force. The reason for this flexibility is that the structure of wages was able to change to accommodate the new structure of supply. The wage rates of the groups whose supply grew rapidly declined relative to the wage rates of adult men.

This flexibility of the labor market is quite remarkable in the light of some of the negative "shocks" that have occurred during the 1970's. The most serious of these is the productivity slowdown of the past ten years, which has meant that average net real wages have been virtually constant during this period. This implies in turn that a decline in group A's wage relative to that of group B can only be accomplished through an absolute reduction in group A's living standard.

## II. *Programs To Combat Structural Unemployment*

There are two major labor market policies that are designed to reduce the unemployment rates of specific groups in the labor force and lower the overall unemployment rate consistent with non-accelerating inflation. These include:

(a) Direct job creation (public service employment (PSE) and wage subsidies) and

(b) Skill training programs.

Other approaches, such as labor market information (the Employment Service), promotion of work incentives (principally the mitigation of the unemployment-inducing features of income transfer programs), and elimination of rigidities (for example, lowering the minimum wage for youth), are not likely to come under serious consideration as a means of reducing unemployment, and I will not discuss them.

### *Public Service Employment*

From a budgetary point of view the most important approach to labor market policy in the U.S. has been the PSE programs—the direct creation of Federally-financed jobs in State and local government (and, to an increasing extent, the non-profit sector). The original purpose of PSE was to provide counter-cyclical stimulus as well as fiscal relief to local governments. The youth employment programs, however, were designed to help persons with severe structural unemployment problems, and the design of the adult PSE programs has moved in this direction. Moreover, the recent welfare reform proposals have components that include rather highly targetted PSE jobs for adults.

To what extent can PSE programs influence the structure of unemployment rates at a time when the economy is approximately at capacity (i.e., when there is neither a tendency for the underlying rate of inflation to increase or decrease)? This is a complicated issue, and, not surprisingly, it is quite controversial among economists.

In order to have an impact on both structure of unemployment and the rate of unemployment consistent with non-accelerating inflation, PSE programs must be targetted toward those groups in the labor force that have the most severe labor market difficulties. The initial PSE programs (the original EEA and CETA Titles II and VI in the first few years) were, by the most charitable interpretation, targetted toward the middle of the skill distribution, so they had little impact on structural unemployment. (To be fair, their major purposes were to increase aggregate demand and serve as vehicles for revenue sharing.) During the past few years there has been a significant increase in the degree to which non-youth PSE programs are targetted. There remain, however, several problems with the use of local governments as intermediaries in these programs.

Even if the PSE programs are optimally targetted, they will have a significant impact on the unemployment of the target groups only under certain conditions concerning the way labor markets work. The major condition is that the private sector wage rates of the groups that are the targets of PSE programs must be rigid relative to the wage rates of other, "fully employed" groups. If, instead, the wage rates of the target groups are flexible relative to other wages, additional public sector jobs will merely reduce private sector employment on an approximately one-for-one basis. In other words, the PSE program will result in labor market displacement rather than a *net* increase in employment.

My analysis of this question suggests that—with the significant exception of minority youth—the U.S. labor market is quite flexible. If this is correct, it follows that most PSE jobs, even if they represent additional hiring by State and local government (a controversial assumption), do not have very much impact on either the structure of unemployment or the overall unemployment rate consistent with non-accelerating inflation.

The youth employment programs do appear to be heavily targetted toward minority youth, and it is quite likely that the unemployment rate of black teenagers would be much higher in the absence of these programs. On the other hand, between 30 and 40 percent of employed black teenagers in 1978 were participants in the various youth employment programs, so there is some question about the potential for expanding these programs.

It should also be pointed out that my negative conclusion concerning the employment impact of most PSE jobs refers only to periods in which the labor market is more-or-less in balance. I do *not* mean that PSE is a poor counter-cyclical tool. On the contrary, PSE is at least as effective as tax cuts if it can be "turned off" when the economy recovers.

### *Wage Subsidies*

The second form of direct job creation is the provision of incentives to private employers to hire certain groups in the labor force. The major example of this approach is the Targeted Employment Tax Credit, which is an attempt to lower the relative cost to firms of hiring economically disadvantaged youth and other groups with employment problems.

The assessment of the potential of TETC to influence the structure of unemployment rates and the overall unemployment rate consistent with non-accelerating inflation is quite similar to the analysis of the effects of PSE. There are special programmatic problems with wage subsidies: firms will attempt to receive the subsidy for doing what they would have done without the subsidy (just as local governments will attempt to hire the same people they would have hired without the PSE grants). To the extent, however, that the subsidy is tightly targeted toward labor force groups characterized by rigid relative wage rates, it can reduce overall unemployment to some extent.

### *Training Programs*

The other major approach to labor market policy is to provide skill training to individuals who have slipped past the formal schooling system without getting an adequate preparation for the labor market. This was the major approach of the old Manpower Development and Training Act, and in FY 1978 approximately 350,000 service years of institutional training were provided under CETA at a budgetary cost of $1.4 billion.

The likely impact of these training programs on the structure of unemployment and the value of the overall unemployment rate consistent with non-accelerating inflation are subject to many of the same analytical issues associated with the impact of direct job creation measures. If the programs are targeted toward persons who would otherwise spend their lives in labor markets characterized by rigid wages and severe involuntary unemployment even in peak periods, they can have a large impact on unemployment—as, indeed, can direct job creation measures.

Training programs—to the extent that they effectively increase the skills of participants in them—can also have an impact on unemployment even if the relevant labor markets are characterized by complete flexibility in the sense that I have used that term. Table 2 shows the relation between unemployment rates and educational levels by age for the four sex/race groups in 1970. Assuming that the effect of one service year of training has the same impact on unemployment incidence as one additional year of education (this assumption can arbitrarily be made more optimistic or pessimistic), the cumulative impact of a permanent expansion of training programs on the overall unemployment rate consistent with non-accelerating inflation can be calculated.

TABLE 2.—UNEMPLOYMENT RATES BY AGE, SEX, RACE, AND EDUCATION, 1970

| Age and education | Males |  | Females |  |
|---|---|---|---|---|
|  | White | Black | White | Black |
| 22 to 24: |  |  |  |  |
| 8 | 9.0 | 10.1 | 12.0 | 20.4 |
| 12 | 5.3 | 7.8 | 5.4 | 9.9 |
| 16 | 3.7 | 4.5 | 3.0 | 4.0 |
| 25 to 34: |  |  |  |  |
| 9 | 5.3 | 6.1 | 10.0 | 11.9 |
| 12 | 2.6 | 4.4 | 4.4 | 6.8 |
| 16 | 2.0 | 1.7 | 2.6 | 1.6 |
| 35 to 44: |  |  |  |  |
| 8 | 3.9 | 4.7 | 6.1 | 6.9 |
| 12 | 1.9 | 3.6 | 3.5 | 5.0 |
| 16 | 1.0 | 1.8 | 2.2 | 1.4 |
| 45 to 54: |  |  |  |  |
| 8 | 3.5 | 4.1 | 5.5 | 4.7 |
| 12 | 1.8 | 3.2 | 3.1 | 3.9 |
| 16 | 1.3 | 1.8 | 1.8 | 1.4 |
| 55 to 64: |  |  |  |  |
| 8 | 3.7 | 3.9 | 4.8 | 3.9 |
| 12 | 2.3 | 2.4 | 3.1 | 3.5 |
| 16 | 1.7 | 1.6 | 1.2 | 1.9 |

Source: U.S. Census, 1970.

The results of such a calculation for an expansion, starting in 1979, of institutional training programs by 1,000,000 service years is reported in Table 3. This calculation also assumes that the programs are targeted the same way they were in 1977. The budgetary cost of such an expansion would be about $4 billion (in 1979 dollars). It is clear from the figures in the right-hand column of the table that—based on these assumptions—very little reduction in the overall unemployment rate consistent with non-accelerating inflation could be expected from a quadrupling of the scale of institutional training programs.

TABLE 3.—HYPOTHETICAL CUMULATIVE REDUCTION IN POTENTIAL OVERALL UNEMPLOYMENT RATE DUE TO EXPANSION OF SKILL TRAINING PROGRAMS BY 1,000,000 SERVICE YEARS, BY NUMBER OF YEARS AFTER EXPANSION

| Years after program expansion | Year | Percentage point reduction in unemployment rate |
|---|---|---|
| 1 | 1980 | 0.01 |
| 2 | 1981 | .02 |
| 3 | 1982 | .03 |
| 5 | 1984 | .05 |
| 10 | 1989 | .09 |
| 15 | 1994 | .13 |
| 20 | 1999 | .16 |
| 30 | 2009 | .20 |

It could be argued that these calculations are much too pessimistic (or, indeed, that they are to optimistic). But even if one were to assume that the programs were three times as effective in reducing unemployment as my set of assumptions assume, the impact of such an expansion on the unemployment rate would still be very small throughout the 1980's.

*A qualification.*—It should be stressed that the reduction in the lifetime unemployment of participants in these programs is only a side effect of the major impact of training programs. Their primary benefit is the increase in future earnings of participants while on the job, which is in turn reflected by an increase in the average productivity and GNP of the economy.

### III. *Conclusions*

For the reasons discussed above, I am not optimistic about the prospects for our conventional employment and training programs having a significant impact on the structure of unemployment or on the overall unemployment rate consistent with non-accelerating inflation. An across-the-board doubling of budgetary resources for employment and training programs might lower the potential overall unemployment rate in five years by two or three tenths of a percentage point if the expansion of these programs were efficiently managed. But it is unrealistic to expect miracles of these programs.

There is an additional complication on the horizon that has very serious implications concerning the question of the likely course of the structure of unemployment rates and for labor market policy in general. That is the dramatic spurt of immigration of low-skilled labor into the U.S. from Mexico and other Latin American countries. There is no question but that this influx has lowered the relative earnings of low-skilled workers in the U.S. and it may be responsible for much of the increase in the relative unemployment rates of minorities.

The degree to which the government would be able to lower the rate of illegal immigration into this country is apparently subject to question. Whether or not we should try to limit immigration is a political question involving several diverse considerations. However, there are enormous differences in the wage rates for low-skilled workers in the U.S. and the source countries, and population pressures will continue to increase in Latin America. Thus, the immigration we have experienced thus far (perhaps 5 million persons engaged in labor market activity) may be small compared to the influx that will occur during the rest of this century.

If immigration of low-skilled persons does occur on such a large scale, it will improve the labor market status of persons with relatively high skills and lower the status of those in the domestic population without adequate training, and the magnitudes of these changes could be very large. The role of labor market policy in this circumstance, it seems to me, should be to mitigate the impact of a deteriorating labor market on those segments of the domestic population who have not gained access to higher skilled jobs through the normal training system.

Put differently, the immigration factor suggests that we will be fortunate if labor market programs can keep the level of structural unemployment (and, more importantly, underemployment) from getting much worse in the next decade.

Representative Mitchell. I have got to go back to square 1. I guess what I really need is your definition of structural unemployment, from both of you gentlemen. I have several working definitions, but I raise the question because in my mind I don't think the present unemployment rate of 5.8 percent reflects structural unemployment. I think that is more cyclical unemployment than structural, and in order to get at that, I would like to get your definition, first, of what is structural unemployment.

Mr. Nichols, then Mr. Johnson.

Mr. Nichols. I spend a few pages of my prepared statement telling you why I can't answer that question.

Representative Brown. We are going to try to help you.

Mr. Nichols. OK. That is good.

As I said, I think the structural, frictional, seasonal and cyclical factors are all linked up together. I don't think it is possible to take a single worker and say, "You are structurally unemployed."

Yes; I do feel it is possible in principle to grade the labor force and to agree that those at the top of the ladder have no structural problems and those at the bottom do have structural problems.

I think it is very difficult, however, to agree where to draw the line. Do I say someone unemployed 15 weeks or 14½ weeks? There is surely a lot a difference between an employee unemployed 14½ weeks and one unemployed 30 weeks and one unemployed 2 weeks.

Arbitrary classifications have to be made, essentially arbitrary decisions about what we will define as structural unemployment. That makes it very difficult to come up with the uniform agreement on the decisions among the experts who analyze these data.

The structural characteristics themselves are impossible to measure without error. We can talk about people, for example, without a high school education. That is a labor force category that has a much higher unemployment rate than the other, but what is meant by high school education? It means very different things for very different individuals. Numbers of years of schooling mean different things directed toward different occupations.

If I had to pick a working definition, I would go with the 15 weeks of unemployment. I think that is a useful way of getting at the people who are severely unemployed.

One thing wrong with that is that it ignores lots of people who pass in and out of the labor force, and don't look for work because they don't think the jobs are there. What we call discouraged workers are in a sense even worse off than the workers who are unemployed 15 weeks and are not satisfied, by definition. I have no single definition that I think would be appropriate, but if I had to pick one, I would go with the 15 weeks.

Representative MITCHELL. Mr. Johnson.

Mr. JOHNSON. I don't have any precise definition of structural unemployment, but my view of structural unemployment is rather more technical. It seems to me that unemployed persons are structurally unemployed if they are in labor markets whose wage rates are characterized by rigidity.

Thus, increases on the relevant supply of persons in that labor market will not increase the total employment of persons in that labor market. Increases in demand will increase the total employment of persons in the labor market.

Representative MITCHELL. Well, I guess I have to confess to some discomfort. How in the world are we going to tackle the problem of structural unemployment if we cannot define it?

Mr. Nichols, I am not at all sure that I would want to define it in terms of number of weeks out of work. I am not attempting to deprecate anything that either of you gentleman has said, but I think this is one of the major problems as to why the Congress and the administration have not acted in a more forthright fashion in tackling structural unemployment. We simply don't know what it is, and we look to you to define it for us. Obviously, once it is defined, then we have to identify where it is and how long it has been there and what we ought to be doing about it.

Nevertheless, despite my discomfort with the lack of definition, I would like to raise one more question and then I will yield to my colleague.

There is a school of thought which says that structural employment programs should depend upon some kind of trigger mechanism, such as a certain percentage of unemployment as compared to the national average, and when that percentage is reached, it should trigger the start of some programs.

I am not at all sure I would agree with that, and I would like to hear your comments before I tell you I would not agree with it.

Mr. Johnson and Mr. Nichols, do you favor a trigger mechanism for implementing or kicking off programs that deal with unemployment?

Mr. Johnson. Not to deal with structural unemployment. Structural unemployment almost by definition will linger through the best parts of the business cycle as well as the worst. There is a very major additional problem that, if you gear your structural efforts to the aggregate unemployment rate, when the unemployment rate goes up, a fraction of the unemployed with good training and experience rises, because they are cyclically unemployed, and it is, I think, a misuse of funds to treat those people as structurally unemployed.

Again, through a decentralized manpower system, the people who are served by CETA tend to be the ones that are educated, that can better help the cities do whatever services they want, so I would fully agree with the motion that these programs not be triggered.

Mr. Nichols. Well, I think the trigger mechanism is more appropriate for combating cyclical unemployment, because its overall role is to reduce unemployment in times of recession. On the other hand, this Baily-Tobin framework lets us break the unemployment down into two groups on practical grounds that gets around this question of what structural unemployment is.

It asks what can be done without an increase in inflation, which gives us one answer as to how low unemployment can go. Then it asks how much more can be done with other programs. I think the practical answer that comes from that analysis would be of great use to us. But what that number really is is the number of structurally unemployed people we can actually put to work, given the overall constraints on the problem. While that number may not include the whole group, it is useful. To be able to know what we can do, I think, is extremely useful.

Representative Mitchell. I asked also that you comment on whether or not the present unemployment rate, whatever the national average is, reflects structural unemployment. I indicated that I did not think that it does. I think it is primarily cyclical unemployment that we measure rather than structural, by the 5.8 or 6.2 percent unemployment rate, whatever it is.

Mr. Nichols. Certainly the variation is cyclical. The month-to-month or year-to-year changes of this unemployment rate, the change is due to cyclical unemployment, but the fact that it never gets to zero means that it is picking up structurally unemployed workers in there.

Representative Mitchell. Would you hazard a guess as to what percentage of the present national unemployment rate is structural rather than cyclical?

Mr. Nichols. I would say we could chip away maybe a point to a point and a half of that overall rate through structural programs.

Representative Brown. What do you mean by a point to a point and a half?

Mr. Nichols. If the unemployment rate comes down as low as it can go in a noninflationary way, we could probably reduce it a further point to a point and a half with structural programs.

Representative Brown. What do you mean by 4.8? Do you mean from 5.8 to 4.3, or 5.8 to 5.64?

Mr. Nichols. I am sorry; a percentage point and a half.

Representative Mitchell. Mr. Johnson.

Mr. Johnson. I would say about a point of the present 6 on average is in structural, and I don't really believe that we could call any part of the present unemployment rate cyclical.

Representative Mitchell. None of it?

Mr. Johnson. At most zero, possibly about minus point 5. We are at the peak of a business cycle——

Representative Mitchell. I want to pursue that, because, based on my reading and experience, even at a peak you can still have cyclical unemployment, but I have taken up so much time, and Congressman Brown has some questions. I would like to come back to that.

Representative Brown. Congressman Mitchell, you won't find my questions different from yours in this regard.

Now, I suggested earlier on that you were here to help us. Maybe we are here to help you. Let me by my line of questioning try to help you, if I can.

There are those, as you and Congressman Mitchell and I know, who suggest that while 4-percent unemployment was considered to be full employment back in 1946, that it now is 4.5 percent or 5 percent or even higher because of the social benefits that have been built into our society since 1946 that tend to sustain those who are unemployed.

I won't try to give you a whole list of those, but they obviously include some things that are currently in the headlines—social security benefits for widows and their teenage youngsters who may be going to college—but more particularly let's just limit our discussion to unemployment benefits and supplemental unemployment benefits.

Now, I think that suggests something to us, and I would like to put it into this framework. I have a major truck-manufacturing facility in my district, and from time to time their models change, due to Federal regulations and this leads to a layoff of people. A lot of those engines have to be redone, reengineered, and so forth—that is a little help from the Federal Government to create unemployment.

The people who work on the line get their unemployment benefits, their supplemental unemployment benefits, and for the first few weeks, at least, may decide to take off for Florida to go fishing if it is in the winter, or if it is in the summer they go back and help the old man on the farm, and in exchange for that kind of help pick up a side of beef or something else that the farmer decides is a kind of compensation for that assistance. But they are still unemployed, and the statistic is very easy to get because they are listed on the unemployment rolls because they are getting unemployment benefits.

Now, that guy is unemployed. But structurally unemployed? I think not. He has got a job waiting for him as soon as that situation in the factory improves, whether it is a marketing factor or something that is caused by Uncle Sam.

Congressman Mitchell asked how accurate is the unemployment data. I would suggest that it becomes much less accurate when you get into the truly structurally unemployed. That teenager at 18, though, has got the decision as to whether he becomes a street dude or actually goes to the unemployment office and applies for a job. He cannot apply for unemployment compensation, and he probably does not have enough confidence and maybe not enough knowledge of the system to go and apply to the U.S. Employment Service or the State Employment Service to get a job.

Now, I would say that he is more unemployed, if you will, than the fellow who is laid off from the truck plant and decides to go down to this place in Florida and go fishing for 3 weeks.

So what I am getting at is this. Would you assess for me the impact of unemployment benefits in creating unemployment but also in giving us a reading of the structurally unemployed, somebody who is drawing unemployment benefits who, I submit, may not be quite structurally unemployed? Do you want to comment on that?

Mr. JOHNSON. I would agree with that, he may not be. That person drawing unemployment benefits may be a member of the induced unemployed but the system of transfer payments has made it possible for him or her to take a vacation or work somewhere else legally so to speak.

I think that that is one of the major reasons.

There are many papers, studies, of this problem, and there is a very wide range of estimates, most of which are not terribly reliable, about the impact of the changes in the transfer programs that have taken place in the last two decades on the unemployment rate consistent with nonaccelerating inflation.

It may be very large. It may be that this factor, unemployment compensation, is part of it. It may be one of the reasons why, at the peak of the business cycle now, we have such a high unemployment rate compared with what things were even 5 or 6 or 10 years ago.

So, in large part, I agree with you, but there we don't know as much about this as we should in order to make definitive statements.

Representative BROWN. Mr. Nichols.

Mr. NICHOLS. I would certainly agree that the worker in a temporary layoff from presumably a good job in the manufacturing sector does not have the structurally unemployed problems. He is collecting his unemployment insurance. However, the unemployment rate should tell us how well the economy is providing employment opportunities for workers and since this worker is not being served, it is appropriate that he be counted.

Presumably, if he has unemployment compensation, he is less a social problem than the worker who goes down and applies for a public service job and cannot qualify for unemployment compensation. Clearly the second worker is much more of a social problem.

It is, of course, the purpose of unemployment insurance to supplement people's income during temporary layoffs. We knew when adopting that law and when making the law, it is going to take the heat off the workers and not force them to go out and search for jobs. It may be a characteristic we don't like, but I think we are aware of that when we adopt such a system. The benefit of the system outweighs that problem.

Representative BROWN. I am not knocking the system; I am trying to determine what structural unemployment is, and maybe we should call it socially unemployed, because I want to reverse now the situation. I cannot describe in detail but, let's assume he dropped out of school at age 13, and he has been identified as a juvenile deliquent; he has no training, he has an unemployed mother and father; he has no capacity to understand what unemployment is, and so forth.

That, it seems to me, is the kind of person that is not a very hot commodity on the job market.

Now, let's go to the other end of the scale and that is the impact of government on unemployment, such as the termination of Boeing's employment in the supersonic transport. There were a lot of fine engineers out there who were working on that SST who, all of a sudden, increased very radically the unemployment rate in Seattle. The guy has got his graduate degree in engineering. He may be in Seattle unemployed long enough that he has run out of his unemployment benefits and has to live off his savings and has to take a loan on the house that he may have paid the mortgage off on. Is he structurally unemployed?

Mr. **Nichols.** You imply he is less a social problem than the person with no knowledge of the world of work, and I certainly agree, but there is a structrual element to this person's unemployment in the fact that it is extremely difficult for him to find work where he lives.

Representative **Brown.** And don't miss the point that he has exhausted his unemployment compensation now.

Mr. **Nichols.** Yes; he is a problem. If nationwide there were a surplus of this kind of engineer, I would say we would need some sort of retraining, because here is a capable worker that the Nation should not waste, and some way should be found to make use of him.

Representative **Brown.** Well, I merely raise these points to suggest that there are two elements in structural unemployment, both of which focus to one measure of structural unemployment. One is what I would call socially unemployed, that is, my street dude, or it might even be that 40-year-old housewife who is very good at dishes, diapers, dusting—you know, the three big D's—but does not have any skill that she can now peddle on the market to get a good job. She is in the same situation to some extent as the street dude.

That is social unemployment, it seems to me, but it seems to me also that the guy at Boeing who is the engineer, if the country has decided that we are not going to have a lot of jobs for engineers, and if he is located in a place where that job is not available for the skill he has, then he faces some degree of structural unemployment. That person is also structurally unemployed. So would not the good measure of structural unemployment be whether or not the unemployed person now can qualify for unemployment benefits?

Isn't therefore, your 15-week determination perhaps a little too arbitrary, and we should say the structurally unemployed are those who cannot qualify for the benefits?

Mr. **Nichols.** That would be a good measure of unemployment as a social problem certainly, which is one of the purposes of the rating. It should also serve its purpose, I think, as a measure of the labor market tightness for purposes of macro policies.

Representative **Brown.** I would only conclude with this thought. I have overrun my time, too, Congressman Mitchell, but let me just say that is not to suggest that we don't give a hoot about the guy who is on the 8th month of a 9-month availablity of unemployment benefits, because in another month he will be structurally unemployed, he has run out of his benefits. It seems to me that the first priority of attacking the problem of structural unemployment ought to be in the area of those people who are not served by the system—the system of benefits to aid the unemployed.

Thank you, Congressman Mitchell.

Representative Mitchell. Thank you.

Just one brief comment which Congressman Brown's comments cause me to make. There are at least three elements in structural unemployment, it seems to me. No. 1, what does the guy or gal have to offer in terms of meeting the requirements of the manpower market? What skills do they possess?

No. 2, what are the requirements of the manpower market?

No. 3, it would seem to me, is whether or not any person, male or female, has a finite unemployment level.

I think, if we try to approach it in terms of those three variables, we begin to move away from the 15-week period of unemployment. We move away from a whole lot of extraneous things to three rather fundamental things in attempting to define structurally unemployed.

A sixth-grade education, a nonfarm situation, an urban dweller. It may well be that that is an illustration of the first part of the first variable. What are we looking for in the urban situation? Engineers? Welders? Obviously that would be the second part.

I merely throw that out to you because I just feel uncomfortable in attempting to work with the Congress in addressing this problem unless we know how to define it.

Gentlemen, thank you very much.

I have a number of other questions, and I am sure Congressman Brown does, too. I don't know what time constraints you are working under. However, I would prefer that you stay, because there are many, many more questions to be raised.

Thank you very much, gentlemen.

Representative Brown. And some more to be directed, too, maybe.

Representative Mitchell. Our next witness is Michael L. Wachter, professor of economics at the University of Pennsylvania, on the faculty since 1969, and now serving as an adviser to the Minimum Wage Study Commission, and who has had numerous consultant positions, including the Council of Economic Advisers, and the National Bureau of Economic Research.

May I introduce now our fourth witness at the same time, and they can go right into their testimony.

The fourth witness is Mr. Charles C. Holt, director of the Bureau of Business Research and professor of management from the University of Texas in Austin.

Gentlemen, welcome to both of you. We are delighted that you could join us, and we await your testimony. You may either present your entire prepared statements or extract from them.

## STATEMENT OF MICHAEL L. WACHTER, PROFESSOR OF ECONOMICS, UNIVERSITY OF PENNSYLVANIA

Mr. Wachter. Thank you for the opportunity to testify this morning.

What I would like to do is depart from my prepared statement to deal with some of the questions you asked of the previous witnesses. This will orient my comments in the directions of greatest interest to the committee.

Representative Mitchell. That will be fine.

Mr. **Wachter**. Let me suggest that my own research does imply that we have approximately zero cyclical unemployment currently, that is, that we have fully recovered from the 1974–75 recession.

I think that implication has important policy implications and I would argue indeed that one of the problems that we have had over the last decade is too much emphasis on cyclical policies and too little on structural policies.

I would argue that one of the reasons the inflation rate has increased from 1 percent to 8 percent over the past 15 years is that we have been overheating the economy with cyclical policies.

Much of the current CETA program, for example, is a cyclical policy and does not contain significant structural components.

I think that the issue of where the cyclical unemployment rate is should be viewed as a nonpolitical question. It is very possible to argue that the full employment, unemployment rate is 6 percent and then to argue, as a starting point, that we need to spend more money on these structural measures. What it calls for, then, is a drastic shift in policy aimed at solving the manpower problems from a structural perspective.

If you look at the programs adopted over the last decade, which have largely been cyclical in nature, we have not succeeded in narrowing the unemployment rate differential between whites and minorities. This lack of a success is related to the use of overexpansionary monetary and fiscal policies. I believe that the answer to the problems of high unemployment and large racial unemployment differentials involves moving away from direct job creation and toward manpower training targeted at disadvantaged workers.

I am also less concerned about increasing unemployment by encouraging those who are out of the labor force to seek work. I think that there are many individuals out of the labor force, who want to work but don't have adequate skills. We should be very pleased if they would take on the training programs that the Government should provide for these workers.

That is, we are too concerned about the appearance of a high measured unemployment rate because it leads to inappropriate, inflationary, overexpansionary monetary and fiscal remedies. Because of this we leave many out of the labor force who really should be brought into training programs and from training programs either into full-time or part-time jobs.

Let me move on, then to my prepared statement. Unemployment policy concerns should focus on providing skills to low-wage individuals. The main shift that is occurring in the profession in dealing with cyclical unemployment is to redefine that term so that it has some meaning in terms of the inflation rate.

More specifically, what is needed is a measure of unemployment which controls for acts of God and acts of OPEC, which I don't put on the same level.

Representative **Brown**. The same impact.

Mr. **Wachter**. We want to abstract from those two forces. We want to measure the level of unemployment that we can reach without accelerating inflation.

The evidence that both my liberal and conservative colleagues have gathered, as well as my own work over the last 5 years, indicates that that rate is currently in the area of 5.5 to 6.2 percent.

I think there is a fair amount of uncertainty as to what that rate is, which is unfortunate, but I have not seen anyone who has researched this problem who has been able to make a strong case for a rate below 5.5 percent today.

That is, anything below 5.5 percent today, using purely cyclical policies, would mean accelerating inflation.

This is a different definition of cyclical and structural unemployment than the traditional notion because of the important caveat that there is a second goal of nonaccelerating inflation. That is, our measure of the full-employment rate is now compatible with nonaccelerating inflation.

When we reach that level of unemployment, approximately 6 percent, however, it is not a signal to stop spending money on manpower programs. Rather, what is needed is a policy shift of moneys from cyclical programs into programs to train disadvantaged workers. The best policy, for the 1970's, however, is one which stresses structural remedies throughout the cycle. In general, these policies should not be funded on a cyclical basis because the problem is acyclical. In this context, the planned reductions in the CETA program are ill timed. Current attempts to strengthen the structural components of CETA should continue without budgetary cutbacks.

I think much of the structural unemployment that we have today is in some ways not a problem so much of unemployment as it is of low wages. This gets back to the notion that we are living in a welfare society. This is related to Congressman Brown's comment on unemployment compensation, but I would extend that to food stamps, public assistance, and so on. My own view is that a wealthy society such as ours can well afford current welfare levels and indeed they should be indexed to keep them unchanged in real terms.

In this context, it is useful to define a term which I call the cost of being unemployed. It is essentially the difference between the market wage someone can earn by working (more or less full time) and the transfer wage that person can get from the Government by not working. Individuals who choose not to work and to draw the transfer payments, and who could work, are not living at a high level; and they are not high spenders; they are not in the middle class. Rather, they are in a disadvantaged category. They are a social problem whether they are out of the labor force, unemployed, or even working part time. The problem, however, is largely caused by low wages and inadequate skills. Unemployment is only a symptom of the problem.

The reason they spend so much of their time being unemployed is not a lack of jobs but rather because their wages are so low that the jobs that are available are not attractive.

There are many, many jobs available today at 6 percent unemployment, and a lot of these jobs are not attractive jobs and are not being taken.

What I am suggesting is that the answer to the problem of unemployment is to deal with it as a wage problem and not as an unemployment problem.

We have to increase the cost of unemployment. The way to increase the cost of being unemployed is to increase the skill levels of workers, so that they can earn a higher wage.

That is, we have to move away from direct job creation which is the heart of the CETA program, and move toward manpower training, employment tax credits, and so forth, which will provide an environment for workers to gain the training which will lead to the higher wages which will make it prohibitively expensive for them to be unemployed.

That is, they won't be able to afford to be poor any more. The solution is in increasing the skill of workers, not in increasing the number of government, public service jobs.

I am very disturbed by the implications that are sometimes drawn from the Baily-Tobin analysis. My comments, however, are not addressed by my colleague, Mr. Nichols, because he was not drawing these implications.

What is often forgotten in the Baily-Tobin analysis is the fact that when you target CETA programs, that do not provide training but simply provide jobs, to decrease the unemployment of some groups, this implies an increase in the unemployment of other groups. The Humphrey-Hawkins type of legislation ignores this issue but it is clear from the type of analysis of Baily and Tobin as well as others who have rigorously studied targeted programs. If you utilize targeted programs, and maintain a posture that these must be compatible with nonaccelerating inflation, then to increase the employment of disadvantaged workers means a decrease in the employment of unionized workers, workers in manufacturing, in mining and construction.

Now, there is not a 1-for-1 tradeoff, and this is why you could lower the aggregate unemployment rate. Because the structurally unemployed are at lower wages and a lower skills level, you can hire three or four of them and just displace one very skilled worker and, in a sense, the tightness of the labor market will remain unchanged. The evidence that I have is that the tradeoff is approximately 4 to 1. Targeted programs, without the training component, provide approximately four new jobs to disadvantaged workers at the cost of one skilled worker's job.

Some may well say that those programs are desirable and they want to go in that direction to have a more even distribution of unemployment. But I would suggest that there is an alternative approach which does not require the increased unemployment of any particular group.

These kinds of programs stress manpower training. The crucial issue, to me, comes down to the following question that I would suggest as a policy matter.

The CETA program, at its best, provides funding for 1 year, for someone who is 20 years old, who dropped out of high school when he or she was 16, and has been kicking around the labor market more or less unsuccessfully for the last 4 years. What is to be gained by providing a job with no training, for 1 year, in 1977-78 when the labor markets were fairly tight? Unfortunately, even this picture is optimistic. The average length of time these people do spend in the program is less than 1 year. I think we have to recognize that the problems are much more serious than implied by viewing it as a cyclical policy or a structural problem that will disappear in 1 year.

It is my view that the full employment-unemployment rate which is compatible with nonaccelerating inflation, provides a framework in which the problems of disadvantaged youth are more serious than would appear in a Keynesian world where unemployment can be permanently reduced by providing public service jobs. With these latter policies in effect, we have been overheating the economy, achieving higher inflation rates, but have made no progress in improving the position of this group.

I view the current CETA program as somewhat of a step in the right direction in that it is beginning to target funds more toward disadvantaged workers than they were doing before.

Unfortunately, the CETA program today still suffers from a lack of clarity on goals; it does not take a stand on whether full employment is compatible with nonaccelerating inflation. In addition, it contains three goals that compete for funds: countercyclical job creation, help to hard-pressed cities, and help to disadvantaged workers. These three components of the CETA program should be split apart into separate programs.

The first, countercyclical job creation, should be dropped entirely because it has probably been counterproductive. If you look at the history of direct job creation over the last decade, you will find that it tends to be contracyclical; that is, it reinforces the cycle.

At the time CETA was creating jobs, the economy was well into the recovery; and once again in 1978, the economy is slowing as CETA is cutting back on jobs.

I am not going to comment on the issue of the cities because that is well beyond the scope of this hearing.

The third of the CETA goals is manpower training. Most of the funds should be moved from job creation to training programs.

I think that although our record with training programs is mixed, that does not mean that we should give up on them. In fact, we have not tried very hard so we should not be so depressed to begin with. Most so-called training programs have provided little training.

Second, we have learned some things from these programs in the past and we can benefit from those experiences. For example, most of the training should be done in the private sector and not in the public sector.

From speaking with business executives, it is clear that a number would be interested in providing manpower training. This would be performed by a special unit of the firm and for a profit. Manpower problems are too serious to be left to the social consciousness of individual groups.

If you are trying to create transferrable jobs for private-sector work, who is better to do the training than the private sector?

I think that by and large the CETA effort should be shifted dramatically toward providing incentives for training in the private sector.

Second, I think the new jobs tax credit that was passed last year was by and large successful. The current program, hopefully, will also be successful. The tendency to change programs every year makes it almost impossible to evaluate them thoroughly, but I think that tax incentives to employ disadvantaged workers seems to have promise.

So, I think that we do have a menu of choices, but it is a menu which excludes many of the popular programs of the past decade. If we choose policies from this new set, I believe that the economy could, over time, reduce substantially the unemployment rate compatible with nonaccelerating inflation.

Thank you.

Representative **Mitchell**. Thank you. That is provocative. Certainly, you have said some things that I think I would take serious issue with, and I hope I will get the opportunity to do so.

[The prepared statement of Mr. Wachter follows:]

## Prepared Statement of Michael L. Wachter

### *Unemployment Policies To Reduce Inflation*

This paper analyzes three aspects of the unemployment problem. The first is the cyclical character of unemployment. Is cyclical unemployment an important part of today's problem? The second is the level of the sustainable unemployment rate: Why has that rate increased from about 4 percent in 1954 to over 5.5 percent today? The third has to do with policy options: What are the uses and misuses of monetary and fiscal policies in the current economic environment? What types of structural supply side policies would reduce the unemployment rate without creating upward pressure on the inflation rate?

### I. CYCLICAL UNEMPLOYMENT

As I have argued elsewhere, the current unemployment rate and level of GNP indicate that the United States has fully recovered from the 1974–75 recession. The high level of unemployment which persists in our economy is approximately equal to that unemployment rate which can be maintained without accelerating inflation (for ease of exposition, I hereafter refer to that rate as the equilibrium unemployment rate or $U^*$).

### *A. A description of the equilibrium unemployment*

The equilibrium rate of unemployment, which I estimate to be between 5.5 and 6.0 percent, is the lowest unemployment rate that monetary and fiscal policy can achieve without rekindling inflation. At that level, the pool of job seekers is heavily unbalanced towards unskilled workers. The unemployment rate of skilled workers (broadly defined) is commensurate with our notion of frictional unemployment. Therefore, any overall expansion of labor market demand is inflationary because it increases the demand for skilled workers and capital and these inputs are not available at current money wage and price levels.

### *B. Uncertainty in measuring the equilibrium unemployment rate.*

One of the major problems in the anti-inflation battle is that the appropriate unemployment rate target for stabilization policy is unknown. How far can the monetary and fiscal authorities push down the unemployment rate without causing accelerating inflation? In the 1960's it was argued that uncertainty about the length of the lagged response of economic activity to aggregate demand policies was the key problem in fine tuning the economy. That problem still exists, but I would argue that it is small compared with the issues raised by the uncertainty over the level of the sustainable unemployment rate. My equilibrium unemployment rate of 5.5 percent is a point estimate with a large standard deviation. The unemployment constraint could easily be over 6 percent.

Figure 1 presents two estimates of $U^*$. The first denoted $U^*_1$, attempts to capture the demographic shifts in the labor market; that is, the coming of labor force age of the baby boom cohort and the associated increases in female participation rates. The $U^*_1$ construct also attempts to measure the impact of the changing relative level of government transfer programs. As indicated, that rate increased from 4.0 percent in the mid-1950's to 5.5 percent today.

A problem with $U^*_1$ as a measure of full-employment is that it only takes account of changing labor market factors. Numerous other variables, including such diverse elements as the slowdown in the trend rate of growth of productivity and changes in the terms of trade, could also affect the equilibrium unemployment rate.

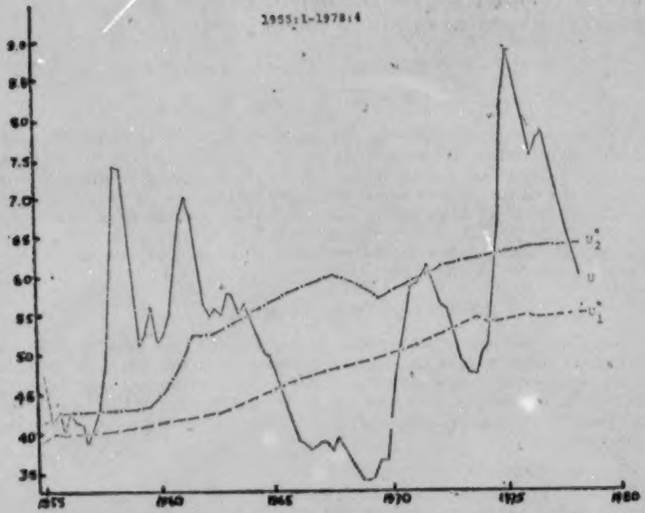
An alternative method of calculating $U^*$ is simply to analyze the inflation data over the postwar business cycles, to find the unemployment rates (in each period) which correspond to stable inflation rates. Statistically, this can be done by inverting a wage or price equation and setting the rate of wage or price change equal to zero. The $U^*$ series which results from using this technique is denoted $U^*_2$ and is shown in figure 1. The $U^*_2$ series is higher than $U^*_1$ throughout the past two decades. For the fourth quarter of 1967, $U^*_2$ is equal to 6.3 percent.

FIGURE 1

$U$; $U_1^*$, AND $U_2^*$

1955:1–1978:4

Source: Jeffrey M. Perloff and Michael L. Wachter, "A Production Function Approach to Potential Output: Is Measured Potential Output Too High?" Carnegie-Rochester Conference Series on Public Policy. Vol. January 1979.



Another indication that U* may be above 5.5 percent is the shifting relationship between capacity utilization and the unemployment rate. It appears that for any given unemployment rate today, capacity utilization is much higher than it was in the 1960's. Whereas the availability of labor was the constraining factor in the 1960's, the availability of capital is the constraining factor today. Inflation in the Wharton model tends to accelerate when capacity utilization is around 93 percent. In the current Wharton forecast, capacity utilization in 1979 will be just above 93 percent and unemployment will be approximately 6.2 percent. That is, we will reach the inflation point on the capacity utilization rate when the unemployment rate is still 6.2 percent. I am not claiming that 6.2 percent is the new equilibrium rate of unemployment. But the capacity numbers are a source of concern and they cause me to wonder whether the 5.5 percent figure that results from the demographic adjustment may be too optimistic.

### *C. Implications*

The government's own unemployment rate target is below the 5.5 percent figure. In the late 1960's the government target was 4 percent and $U^*_1$ was approximately 4.9 percent. By the mid-1970's, when the government target was lifted to 4.9 percent, $U^*_1$ had increased to 5.5 percent. This can help explain the increase in the inflation rate, from an average of 1.5 percent in the early 1960's to approximately 8 percent today

The "full-employment" budget surplus is seriously overstated by calculating that figure on the basis of a 4 or even 5 percent equilibrium or full-employment, unemployment rate. The result is a tendency to believe that fiscal policy is more restrictive than actually is the case. For example, using a 4.9 percent full-employment rate, the Congressional Budget Office calculates a full-employment surplus of −10.3 billion in 1977, −11.2 billion in 1978, and +1.5 billion in 1979. Replacing a 4.9 percent with 5.5 percent target would change the projected full-employment surplus to a significant deficit for 1979 and would increase the size of the deficits for 1977–78.

A commitment to fighting inflation suggests that the government avoid using monetary and fiscal policy to push the unemployment rate below 6 percent. Given the uncertainty over the specific level of U*, policy makers must choose between taking the risks of overheating the economy vs. operating with additional slack. A policy to reduce the inflation rate implies shifting the unemployment rate target toward the high end of the U* range. Such a policy, however, does not require a recession. Slow real GNP growth of approximately 2.5 percent would raise the unemployment rate to the new target. Thereafter, real GNP growth of approximately 2.5 to 3.0 could be resumed. A policy of slowly reducing the full-employment budget surplus should reduce the inflation rate without a recession and reduce the high cyclical unemployment rates that accompany a recession.

The 6 percent unemployment rate target, however, is only the target for monetary and fiscal policies. The goal should be to achieve a lower unemployment rate and a faster GNP growth rate by adopting structural measures aimed at improving the supply side of the labor and capital markets. These policies discussed below, would shift the federal tax and expenditure policies to favor investment in human and physical capital rather than direct job creation and consumption. One important example of this approach would be a major redirection of funds from public service jobs to manpower training in the private sector.

## II. STRUCTURAL UNEMPLOYMENT

### A. *The characteristics of the unemployed pool at full employment*

The characteristics of the unemployment pool are illustrated in Table 1 through 3. The data are for the four quarters ending with 1978:3, a period when the economy was close to, but slightly above, its equilibrium level of unemployment.

The current unemployment rates for the 14 age-sex groups used by the Bureau of Labor Statistics are shown in Table 1. Those rates illustrate that both the actual and equilibrium unemployment rates are highest for the young workers. Indeed, approximately 50 percent of the total unemployment is accounted for by workers in the 16 to 24 age groups. Table 2 shows the tendency for unemployment rates to be highest among lower skilled workers. Specifically, it shows the mismatch between the employment and unemployment pools when the economy is at full-employment. Three of the lowest skilled occupational categories, service workers, nonfarm laborers, and operatives account for 50 percent of the unemployment. On the other hand, these three categories include only 30 percent of the employment pool. Table 3 indicates that layoffs, the cause of unemployment typically associated with recessions and inadequate demand, composed only 11.5 percent of the unemployment pool. Unemployment spells, initiated by voluntary actions of the workers (quits, reentrants and new entrants) accounted for almost 60 percent of the total unemployment:

TABLE 1.—ACTUAL AND EQUILIBRIUM UNEMPLOYMENT RATES BY AGE AND SEX

| Group | Average 1977:4–1978:3 | Equilibrium or U* rate, 1977 |
|---|---|---|
| **Male:** | | |
| 16 to 19 | 15.6 | 15.2 |
| 20 to 24 | 9.3 | 7.9 |
| 25 to 34 | 4.5 | 3.6 |
| 35 to 44 | 2.9 | 2.5 |
| 45 to 54 | 2.8 | 2.5 |
| 55 to 64 | 3.0 | 2.8 |
| 65 plus | 4.7 | 3.6 |
| **Female:** | | |
| 16 to 19 | 17.3 | 16.6 |
| 20 to 24 | 10.5 | 8.9 |
| 25 to 34 | 7.0 | 6.2 |
| 35 to 44 | 5.2 | 4.6 |
| 45 to 54 | 4.3 | 3.7 |
| 55 to 64 | 3.5 | 3.1 |
| 65 plus | 4.2 | 3.5 |
| Total 16 plus | 6.2 | 5.5 |

TABLE 2.—OCCUPATIONAL EMPLOYMENT AND UNEMPLOYMENT POOLS, 1977:4-1978:3

| Occupation | Percent unemployed | Percent employed |
|---|---|---|
| Professional/technical | 7.2 | 15.1 |
| Man/administrative | 4.2 | 10.7 |
| Sales | 5.0 | 6.3 |
| Clerical | 17.0 | 17.9 |
| Craft/kindred | 11.5 | 13.1 |
| Operatives | 18.4 | 11.5 |
| Transport operatives | 3.7 | 2.8 |
| Nonfarm laborers | 10.8 | 5.0 |
| Service workers | 20.0 | 13.6 |
| Farmworkers | 2.2 | 3.0 |
| Total | 100.0 | 100.0 |

Source: Employment and Earnings, various issues 1978.

TABLE 3.—UNEMPLOYMENT BY REASON, 1978

| | Number (thousands) | Percent unemployment pool |
|---|---|---|
| Layoffs | 694 | 11.5 |
| Other job losers | 1,814 | 30.1 |
| Quits | 848 | 14.1 |
| Reentrants | 1,802 | 29.9 |
| New entrants | 871 | 14.4 |

To summarize, when the economy is close to its equilibrium level of 5.5 to 6 percent, the unemployment pool has a number of important characteristics. The great bulk of the unemployed are young workers 16 to 24 and workers with low skill levels. In addition, these workers are unemployed largely because of actions that they have initiated. Only a small minority of workers are on lay-off status which is the type of unemployment normally associated with cyclical fluctuations. Moreover, there are few prime-age skilled workers in the unemployment pool.

*B. The nature of the structural unemployment problem*

The evidence suggests that several factors have been operating since the early 1960's to increase the equilibrium rate of unemployment. Of particular importance is the demographic shift towards younger and female workers. Young workers both male and female, have been increasing as a percentage of the labor force as a direct consequence of the baby boom of the late 1950's. For young male workers, labor force participation rates have increased somewhat, so that the increase in their relative population size translates directly into an increase in their relative percentage in the labor force. For young female groups, including females aged 16 through 34, rapidly increasing participation rates have swelled the population growth into a dramatic increase in labor force growth. Whereas workers age 16 to 24 formed 16.7 percent of the labor force in 1960, they now constitute 25 percent. I estimate that of the increase in the equilibrium unemployment rate over the past two decades, a full percentage point is due simply to the changing composition of the labor force.

A large increase in the flow of young workers into a competitive labor market need not create a structural unemployment problem. Due to the compositional shift, U* might have increased to 5 percent, but it need not have gone above that level. But do labor markets, especially at the bottom rung of the skill ladder, have institutional features which encourage unemployment? Of potential importance are the minimum wage, public assistance, and other transfer programs for the poor. These programs have changed dramatically since the 1960's.

This country, for example, virtually did not have an operational minimum wage policy between 1947 and 1967. Minimum wages were set at a constant ratio to wages paid elsewhere in the economy. The major industries which hired numerous workers at low wages could obtain an exemption from the minimum wage laws by arguing before Congress that if they were forced to pay the minimum, significant unemployment would result. The result was a policy that exempted most of those workers and industries who might have been affected by the minimum wage.

By 1967, the influx of young workers threatened the employment and relative wage status of the older workers in the low paying secondary markets. Congress responded by extending minimum wage coverage to those labor markets. The minimum wage coverage in 1967 jumped from 39.9 percent to 53.4 percent of civilian employment, and that jump largely extended coverage to low-wage workers. There had been some minor increases in coverage before 1967, but increasing the coverage rate has an impact only when it affects the workers who are actually earning the minimum wage. Throughout the postwar period, by far the most significant change in the minimum wage coverage was the increase in 1967.

At the same time, Congress increased welfare payments. In the 1960's, Aid to Families with Dependent Children (AFDC) payments grew relative to the market wage. The biggest rise in welfare payments, was "in-kind" transfers such as the Food Stamp Program.

As a consequence of the baby boom and the changes in government labor market programs, a pattern of high frequency-low duration bouts of structural unemployment has become the norm. The low-skilled worker is unemployed frequently, but for short periods. For example, over the past year, the average duration of unemployment was slightly over two months, but approximately half the unemployed were out of work for less than five weeks.

For policy purposes it is useful to divide the noncyclical unemployment pool into two groups; those who come from families with high income and those who come from families with low income. The former includes teenagers whose parents have relatively high income levels, married individuals who have spouses in the labor market and some seasonally employed workers (for example, high skilled construction workers with high family income). For policy purposes, the concern centers on the second group; the structurally unemployed who have low family income. In these cases, low wages, frequent bouts of unemployment, or both, lead to poverty.

In the current pattern of structural unemployment, there are two main reasons for being unemployed. First, if workers' potential earnings, based on their skill, are below the minimum wage, they may have difficulty finding stable employment. The minimum wage law reduces the demand for low-wage workers in the covered sector.

Second, because of the increase in the level of transfer payments, some low-skilled people may not want to work full-time. It is sometimes argued that these unemployed are malingering and that the work ethic should be strong enough to force them to work all the time. For the most part, low-wage workers do not have opportunities to work at enriching, pleasurable, creative jobs. They might want to work part of the time in order to remain eligible for public assistance or unemployment compensation, and to retain their skills. But to work all of the time, when society is willing to provide the present level of support, is not "rational" in the economic sense of the term.

Furthermore, many of the structurally unemployed will "outgrow" their unemployment problems. The low work attachment of this group is often associated with the fact that they are teenagers, who do not have family responsibilities, or females that are heads of households who have too much family responsibility. Both groups will alter their working behavior as they age.

What is the underlying model of unemployment that yields these results? First, it is not a search model in the strict sense. Very little unemployment in our society is caused by people who do not know the current wage and prices or the location of the job opportunities. It is not inadequate searching that causes people to be unemployed. The problem is rather that people who are eligible for welfare and unemployment insurance decide not to work, knowing full well their wage and job opportunities. Since they are willing to work part of the time, they would rather wait in line for a relatively attractive job. If they are going to work, they will only do so at a wage that makes work more worthwhile than collecting unemployment insurance or public assistance.

As mentioned above, the unemployment problem must be analyzed in terms of the worker's life cycle. Young workers grow up, older workers age, and as all get older their situations change. Young workers, especially, change their outlook on life, their skills, and their family needs from one year to the next. The government programs available to them also change from year to year. The unemployment model is not a static one where people look at fixed wages and opportunities, but rather a dynamic, demographic one where people age and change. In this model people are structurally unemployed because of low wages, not because of a lack of jobs or information.

## III. IMPLICATIONS FOR POLICY

We need to reorient our thinking about structural unemployment. If unemployment were merely due to a lack of jobs, then the current popular panacea of public service employment would help. But if it is a question of skill and low wages, different policies are needed.

I believe that the government can improve the structure of the labor market so as to reduce the equilibrium unemployment rate. Although the demographic trends will finally be working in a favorable direction, many problems will remain. An important percentage of the oversized undertrained baby boom cohort will remain in the 16 to 24 age group through the early 1980's. In addition, over the next decade the percentage of disadvantaged, minority workers in the 16 to 24 age groups will grow significantly. For this next cohort of young workers, it should become increasingly clear that the underlying problem is not a lack of jobs. Relatively high unemployment rates will remain as a sympton of the real problem—low wages.

The labor market policies stressed by Congress and the Administration, however, are those geared to problems of aggregate demand. There is little attempt to attack the structural problems. Aggregate demand policies have successfully dealt with the cyclical unemployment from the 1974-75 recession, but there has been no dent in the noncyclical component of unemployment—that is, the remaining 6 percent.

### *A. Public service employment: Jobs without training*

Although there is considerable discussion about manpower training, little training is being funded by government programs. Most government monies are used for public service employment and work experience programs. These programs, however, are not training oriented; they are meant to increase the number of jobs available and lower cyclical unemployment, but they do little to increase the skill of job holders. Whereas direct job creation programs (PSE and work experience) are demand oriented, manpower training is supply oriented since it is structured to increase the skill level of workers.

The Comprehensive Employment and Training Act (CETA) program is the government's major current initiative in the labor market. The trend in policy between demand and supply oriented programs is shown in Tables 4 and 5. The percentage of dollars on training, relative to direct job creation, has declined from 25.6 percent in 1975 to 17.0 percent in 1978. Over this same period, the number of PSE job slots has grown from 111,262 to 725,200. Several observations can be drawn from these numbers. Not only do training or supply oriented programs receive a small percentage of the government's labor market funding, but also the trend in percentage terms is strongly in the direction of demand stimulus through increased direct job creation.

TABLE 4.—CETA PROGRAM EXPENDITURES, BY ACTIVITY, FISCAL YEAR 1975–78

[In millions of dollars and percent distribution]

| Program activity | 1975 [1] | | 1976 | | 1977 | | 1978 | | 1979 [2] | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Dollars | Percent | Dollars | Percent | Dollars | Percent | Dollars | Percent | Dollars | Percent |
| Training | 752 | 25.6 | 1,138 | 21.7 | 1,305.6 | 22.1 | 1,648.1 | 17.0 | 2,133.1 | 18.2 |
| OJT [3] | 118 | 3.9 | 272 | 5.2 | 339.2 | 5.7 | 398.9 | 4.1 | [4] 675.3 | 5.8 |
| Classroom | 634 | 20.8 | 866 | 16.5 | 966.4 | 16.4 | 1,249.2 | 12.9 | 1,457.8 | 12.4 |
| Work experience | 1,355 | 44.4 | 1,491 | 28.5 | 1,494.8 | 25.3 | 2,023.2 | 20.9 | [5] 3,097.3 | 26.4 |
| Public service employment | 900 | 29.5 | 2,425 | 46.4 | 2,938.2 | 49.7 | 5,803.2 | 60.0 | 6,262.0 | 53.4 |
| Other | 47 | 1.5 | 173 | 3.3 | 170.4 | 2.9 | [6] 201.7 | 2.1 | 239.7 | 2.0 |
| Total | 3,054 | 100.0 | 5,227 | 100.0 | 5,909.0 | 100.0 | 9,676.2 | 100.0 | 11,732.1 | 100.0 |

[1] Fiscal year 1975 includes Manpower Development and Training Act and Economic Opportunity Act under CETA sec. 3A.
[2] Administration estimate.
[3] On-the-job training.
[4] Includes private sector initiative.
[5] Includes youth programs.
[6] Includes $5,000,000 disabled veterans outreach program.

Source: "CETA Reauthorization Issues," Congressional Budget Office, August 1978.

TABLE 5.—PUBLIC SERVICE EMPLOYMENT EXPENDITURES AND JOB SLOTS, FISCAL YEARS 1975-78

[In millions of dollars]

| | 1975 | 1976 | 1977 | [1] 1978 | [1] 1979 |
|---|---|---|---|---|---|
| Expenditures: | | | | | |
| CETA title II | 503 | (2) | (2) | (2) | (2) |
| CETA title VI | 246 | 2,179.6 | 2,738.4 | 5,580.5 | 6,035.5 |
| Other [3] | [4] 151 | 245.0 | 199.8 | 222.7 | 226.5 |
| Total | 900 | 2,425.0 | 2,938.2 | 5,803.2 | 6,262.0 |
| Job slots | 111,262 | 290,300 | 344,100 | 680,900 | 725,200 |

[1] Estimated.
[2] Titles II and VI were combined under an emergency supplemental appropriation.
[3] Includes WIN, title I, and title III public service jobs.
[4] Includes $53,000,000 of Emergency Employment Act.

Source: "CETA Reauthorization Issues," Congressional Budget Office, August 1978.

This increase in the number of PSE slots has been in the context of a strongly growing economy that, by 1977-78, was approaching the equilibrium unemployment rate. A 13.5 percent jump in PSE slots between 1976 and 1978 need not necessarily be viewed as strongly *contracyclical* (rather than countercyclical). The overall CETA program has a large number of objectives, some of them conflicting. The goals include improving the market skills of disadvantaged, unemployed workers, countercyclical job creation, and relief for the hard pressed cities of the northern states. Thus, any discussion of public service employment must take into consideration that many of the public service slots simply go to maintain regular local government employment. For the hard-pressed northern cities, this job-oriented revenue sharing has helped to maintain public services. This aspect of CETA, however, has little relationship to the goal of reducing structural unemployment.

The variety of goals of the CETA program are an important weakness. For example, the CETA effort to help the distressed cities was not targeted with great accuracy and was probably contracyclical in its timing. The new directions in the proposed 1979 package also have severe limitations. In the context of a slowing economy, a drastic reduction of PSE slots may again be contracyclical. Ideally, for maximum cyclical effect, this program should have been increased in 1974-75 and then cut back in 1977-78. Moreover, the attempt to target the jobs more carefully towards disadvantaged workers runs into the problem that most city services are provided by relatively skilled personnel. In general the public sector is not the industry that is amenable to hiring lower skilled workers.

Due to these conflicts, CETA should be divided into three distinct programs—one to help the cities in the northern tier that are in financial distress, a second to provide countercyclical demand stimulus, and a third to encourage employment and training for disadvantaged low skilled workers. Combining these three problems is almost guaranteed to produce inefficiency and a lack of success in meeting any of the objectives.

In general, if the government is to reduce the equilibrium unemployment rate it should disentangle the three components. Since my assignment is only to discuss methods of reducing equilibrium unemployment, I shall not address the possible remedies for the other two problems. My major point in this discussion is to highlight the need for a separate structural labor market program. Such a program should be funded in an acyclical manner and should be independent of public sector employment.

A program to reduce the equilibrium unemployment rate must be geared to increasing the market skills of workers. Given that there are more than enough private sector jobs to employ all those who want to work, it is necessary to focus on the fact that those jobs are not filled because they are unattractive. Unemployment compensation, food stamps, and AFDC payments are reasonably competitive with the wage level for these unfilled low skilled jobs; that is, the cost of being unemployed is very low for an unskilled worker. The solution is to raise the cost of being unemployed by increasing the market skills and hence the potential wages of the low skilled workers.

Given this framework for explaining the existence of equilibrium unemployment or U*, a number of important weaknesses in PSE type programs can be isolated. The basic problem is that it does not provide training. It is little more than traditional Keynesian fiscal policy. But the unemployment problem is a structural problem rooted in demographic developments. The current cohort of young workers went through a public school system that was not ready for the big bulge of students of the baby boom generation. They did not receive adequate training and many of them dropped out of school early. In fact, high school enrollment rates began to drop in the late 1960's and have continued to drop until recently. There is a large group of young workers today who have less education than the people who entered the labor market ten years ago. Discrimination and the growing fiscal distress of urban areas have worsened the problems. Providing these workers with public service jobs does not solve the fundamental problem that they do not have adequate marketable skills.

A second problem which is connected with the first, is the issue of transferability. Without training, these people do not have skills that can be transferred to the private sector. Are the structurally unemployed supposed to stay under the protection of a public employment program throughout their lives or is there some notion of moving to unsheltered employment? How can a transfer be successful if the employment program does not provide training? What are these programs supposed to accomplish for the twenty one year old high school drop-out who has no marketable skills.

A third problem concerns the wages paid on these public service jobs. Suppose that many of the current structurally unemployed are without work because of the low cost of being unemployed. In this case, some current schemes that would create numerous low-wage public service jobs would not significantly reduce the unemployment rate. Many of the people who are in the unemployment pool have already indicated that they do not want permanent jobs with a wage close to the minimum. If the government creates a million job slots, they may largely be filled by new-entrants or re-entrants into the labor market. In this case, public service employment would increase the number of workers in the labor market, but not significantly reduce the unemployment rate.

Of course, the government could pay more than the minimum wage for public service jobs. This type of program would not only be attractive to the unemployed and those who are out-of-the-labor force, but it would also be attractive to people who are already employed in the private sector at relatively low wages. A program that hired the best qualified applicants would largely take workers from the private sector. The drop in the unemployment rate would not be commensurate with the number of new PSE jobs. Moreover, it is easily shown that attempts to restrict eligibility to those currently unemployed are easily circumvented.

A fourth problem is inflation. Since the wages paid on public service jobs would bear little relationship to the productivity of the workers and increase the demand for labor (with the economy already at full-employment), the inflation rate would increase. But the problem is deeper than that. Since public service employment programs are similar to traditional fiscal policy, they will have little impact on the equilibrium rate of unemployment. At the same time, these programs often have the stated objectives of lowering the actual unemployment rate below the implicit sustainable level. In this case, public service employment would result in an accelerating inflation rate.

*B. Targeting PSE programs to reduce the equilibrium unemployment rate*

Even with the above problems, it is sometimes argued that PSE programs can still lower the equilibrium unemployment rate by targeting its hiring towards the lower skilled workers. If there is an imbalance of too many unskilled workers, when the economy is at U*, would not the equilibrium rate be lowered by hiring those with the highest unemployment rate? In some versions, such as the Humphrey-Hawkins bill, there is an implicit view that the unemployment rates of the teenagers, females, and minorities could be lowered at no cost to the more skilled unionized, manufacturing, construction and mining sectors. Baily and Tobin, however, have proven that the PSE program cannot be a "free lunch". In order to achieve the reduction in unemployment rates of the lower skilled groups, the unemployment rates for the more skilled groups would have to increase. That is, if PSE can lower the equilibrium employment rate (while balancing inflation), it does so by hiring a larger number of unskilled workers than the number of skilled workers who have to be displaced. The quantitative nature of the tradeoff is unclear. Could PSE hire 10 lower skilled workers and fire only 1 skilled worker or would it take 7 skilled workers to balance the hiring of 10 unskilled workers? Using the equilibrium age-sex unemployment rates as a basis, I would guess that that PSE might be able to hire 3 teenagers for every prime-age male that was displaced.

To summarize, targeted PSE programs may be able to reduce the equilibrium unemployment rate, but it has this effect by altering the mix of the unemployment pool—propping up some groups while knocking down others. The supply side programs, discussed in the next section, avoid this difficult political trade-off by addressing the actual causes of structural unemployment. These supply oriented programs can lower the equilibrium unemployment rate by increasing potential output.

*C. Manpower training: A potential solution*

To solve the structural unemployment problem, the market wage of less skilled workers must be increased relative to the level of transfer payments; that is, the cost of being unemployed must be increased. I am not recommending that public assistance and minimum wages be lowered. The economy can afford a relatively high guaranteed income floor for people who have very low skills or who cannot work. Society is wealthy enough and the social product of low-skilled people is small enough, to afford high level of public assistance as well as a high market wage.

Public policy should focus on increasing the market wage of the group of workers who have suffered on account of the baby boom. That includes not just the young workers, but disadvantaged workers who were caught in the secondary labor market when the baby boom arrived. To increase the market wage of this group, manpower training is needed.

Although some manpower training programs in the past have not succeeded, others have been useful. I believe we can learn from past errors and create successful training programs. This is not the place to discuss the "nuts and bolts" of an alternative approach to training. I would, however, like to stress one aspect of the kind of program that I have advocated: namely, that the focus for training be shifted from the government to the private sector. In the days of the Manpower Development and Training Act, the very low-skilled workers attended government-run classes to learn remedial skills. The classes tended to last for six months. A common complaint was that companies would not hire these workers after the government trained them. But the real question was whether these workers were actually being trained. Six months in a government classroom for high school dropouts does not constitute a major training effort. The graduates of these programs still had employment problems because they still lacked the necessary skills.

I argue that even remedial classroom training should be shifted to the private sector and that these programs should be constructed to last for two years. A number of major corporations have indicated a willingness to conduct such programs. These firms can provide a more current vocational training environment. If the program is to work, it should be based on the profit motive of the large firms and not their social conscience.

Firms providing remedial training need not orient their training programs towards fulfilling their own manpower needs. The rationale is that the workers are being trained for general semiskilled employment, and that an individual who receives both remedial general training and concentrated industrial training in certain skills will be employable in general. In the recent past, when the aggregate unemployment rate fell to 5.5. percent, there was a shortage of entry-level workers for manufacturing and semiskilled service jobs. But a worker who has been through the aforementioned private sector training could be hired as an entry-level worker. He or she would no longer be the "bottleneck" worker who required unusual entry-level training costs to fill even the bottom job on the promotion ladder.

There is some evidence that the goals of manpower training could be achieved through the use of employment tax credits. The New Jobs Tax Credit that was part of the 1977 stimulus package seemed promising. Alternatively, a voucher system targeted to specific groups of workers could be used.

### D. *Capital accumulation*

Whereas semiskilled and skilled workers appeared to be the sole bottleneck to the expansion of the late 1960's, capacity has become at least as important a barrier to achieving low unemployment in the 1970's. This means that policy is needed to encourage capital accumulation. Even in the cases where capital growth does not create more jobs, it removes a bottleneck to employment growth.

A major problem with the current expansion is that the strongest sectors have been consumption and residential construction. Given the indication of a capacity shortfall, tax incentives to encourage a capital expenditure boom were needed as far back as 1974. The failure to have investment leading the recovery has been an important factor in the inflationary pressures that developed in 1978 while the unemployment rate was still above 6 percent. The tax package of 1978 was far too late, and contained too few supply side incentives to avoid the last upswing in the inflation rate.

Given a sluggish economy in 1979, the inflation rate should prove to be relatively stable. The unemployment—capacity figures still indicate a need to orient policy towards encouraging investment. Whether the economy begins to rebound in 1980 or 1981, the strength and magnitude of the recovery depends upon a strong investment path leading to an increase in the rate of capital accumulation. A consumption led recovery will again leave the economy with an unnecessarily high equilibrium unemployment rate at the next cyclical peak.

Traditionally, stabilization policy has been directed towards controlling aggregate demand. In the current environment, however, a program's impact on aggregate supply is more important than its impact on aggregate demand.

The recent reduction in the growth rate of productivity and the increase in the equilibrium unemployment rate, could be offset by a switch from high consumption to a high investment economy. Investment tax credits, and a reduction in marginal income tax rates, could all be part of a pro-investment package. Moreover, the transfer system, excluding social security, is sufficiently small so that these policy changes could be made without reducing the relative level of welfare payments. Over the long-run a high investment policy would yield higher wage rates, lower equilibrium unemployment rates, and consequently a reduction in the welfare population.

Representative MITCHELL. Please proceed, Mr. Holt.

## STATEMENT OF CHARLES C. HOLT, DIRECTOR, BUREAU OF BUSINESS RESEARCH, AND PROFESSOR OF MANAGEMENT, UNIVERSITY OF TEXAS AT AUSTIN

Mr. HOLT. I am very pleased to be here. I would start off by saying I agree with much of what Mike Wachter said, but not all.

Although these hearings are primarily concerned with evaluating policies for reducing structural unemployment, the issues involved can only be understood in the context of the larger inflation-unemployment dilemma, a point which has been made by several of the previous speakers.

The Joint Economic Committee is certainly to be commended for making a fundamental reassessment of policies and needs. The profession has had real difficulty in putting the microanalysis issues in the labor market together with the microanalysis of inflation and cyclical unemployment. This is the key difficulty behind the legitimate questions you are raising about the definitions and kinds of structural unemployment.

The difficulty in giving you good answers is the reflection of the fact that we need a much deeper understanding of what goes on in this very complex phenomena of the labor market. This whole area of research, I am afraid, has been neglected relative to the urgency of our needs.

I want to make basically six points, and I will list them briefly and then come back and elaborate on them.

The first point is that there is a strong long-term interaction between inflation and unemployment. If we have unemployment for any long periods of time above this 6- or 5½-percent level that has been associated with the inflation problem, structural problems will gradually get worse. Aggregate demand, both in terms of monetary and fiscal policy, has an extremely important role to play.

Second, the new targeted, triggered jobs program that has been incorporated in CETA through amendments is, I think, another useful tool for battling the cyclical unemployment problem and certainly is better than income transfers. While I agree with what Mike Wachter said, that giving people temporary jobs is not accomplishing any major contribution to the structural problems, it is contributing to the cyclical problems, and we do have cyclical problems to be concerned about.

Third, the training programs certainly have an important contribution to make remedying the structural problems. I would not limit them, however, to training alone. Placement activities, counseling, and other programs aimed at the whole array of difficulties that lead to the problems in the labor market in terms of low income and unemployment—there is a whole array of things that need to be done, and we don't want to focus on training in a narrow sense.

Fourth, the inflation problem limits what we can do with aggregate demand which has tremendous potential for creating jobs. We can create a tremendous number of jobs and what limits that is the problem of inflation. If we have nothing at all in the manpower area now that makes a significant contribution to fighting inflation I would strongly advocate that we initiate a skill shortage training program oriented toward the needs of employers and the skill shortages that are contributing to inflation.

One of the real difficulties of getting the cooperation of employers that Mike Wachter advocates is that the programs, as they operate now, simply offer very little to employers. If we had a training program oriented toward higher skill levels and contributing to the upgrading process, then we would open many vacancies for lower skilled workers to move into.

We really need a fully integrated view of the labor market, which considers both workers' and employers' labor market problems. The problems cannot be solved independent of the other. Overall, I would say that our current programs are simply inadequate, both in terms of the stress and in terms of their magnitude compared against the size of the structural problems.

The sixth and last point is that there are critical deficiencies in both the organizational and the administration of our current program structure.

We have been concentrating today largely on CETA programs but in addition, we have vocational education programs, the U.S. Employment Service, and many other programs. Clearly, education needs to relate to the school-to-work transition, and so on. Although the CETA effort was designed to integrate manpower programs, it is only a start.

Currently, due to morale and ineffectiveness in the programs much less impact is occurring, considering the amount of money that is being spent.

Now, I turn to more specific detail. On the aggregate demand issue, the shock, particularly from the international area, can stimulate both inflation and unemployment. Indeed, the single shock from the increase in oil prices from OPEC triggered a recession that was almost as severe as the depression of the 1930's. There is current discussion in Congress about a balanced budget through a constitutional amendment and this would be an absolute economic disaster.

If, for example, when OPEC raised prices in 1973, the Government had been required to balance its budget, this would have meant increasing taxes and decreasing expenditures and both of those would have vastly increased the impact of OPEC and instead of the automatic stabilizers in the American economy absorbing much of that shock, it would have absorbed none of the shock and vastly increased both inflation and unemployment.

An active countercyclical aggregate demand policy is absolutely essential and that should be complemented with a trigger-targeted jobs program in the manpower area. When we do allow cyclical unemployment to remain up for a period of time above the nonaccelerating inflation level, the impact is in considerable part on the groups in the labor market that have structural problems.

In restricting demand to restrain inflation, you are trying to influence the tightest labor markets, but when demand falls below their labor capacity, the workers that employers are going to let go are the workers who have the least skills and the lowest seniority.

One of the issues is that our aggregate demand measures are extremely ineffective and very slow in restraining inflation. This means that we need to be very careful to act in a timely way to prevent inflation from building up, but we also need to have programs that are more oriented directly toward restraining inflation.

In understanding the basic dynamics of the labor market, the inflation of wages and prices responds to the level of aggregate demand, but the classical adjustment of real wages in response to unemployment is known to adjust very slowly—one estimate is that it would take 4 years for half of the disequilibrium unemployment to be absorbed by these automatic adjustment mechanisms.

This means that when the economy is disturbed, it is extremely ineffective for the Government to sit by and wait for full employment to return. There is a strong role for countercyclical policies.

Now, what happens when we don't have as many jobs created as we have people who we want to work? Then the question is, which particular groups are going to suffer unemployment? Aggregate demand indicates that somebody is going to be unemployed, there are not enough jobs to go around.

Now what determines what unemployment rate will befall particular groups?

This ties in with the definition of structural unemployment. I don't think that it is useful to talk about the duration of unemployment as a measure of structural unemployment. The average duration of unemployment is something of the order of 2 months for most groups. In other words, when we have 6 million people unemployed in the labor market, if we wait 2 months most of those people will have found jobs, but there will be a new 6 million people unemployed to take their places. The tremendously high turnover of people flowing through the labor market reflects most clearly and dramatically our structural problems.

Traditionally, we have measured turnover largely by a fairly small sample of large firms in the manufacturing sector. Some recent data has been collected that also includes small firms and nonmanufacturing industries. These measurements indicate average turnover rates for the economy of something like 66 percent a year.

Hence, in the course of a year, the flow through the labor market is something like 60 percent of the size of the total labor force.

The labor market is extremely dynamic. There tends to be a fairly constant probability per week of finding a job. The duration of unemployment is not the critical point in thinking about the structural unemployment of particular groups.

What causes unemployment to land primarily on women and minorities and young people is the fact that those groups have very high turnover rates. Understanding turnover requires focusing on employment rather than the unemployment.

These problem groups, in many cases, find jobs even more quickly than skilled workers. The skilled worker who is laid off and expects recall may be unemployed for a longer period of time than the teenager. Often the teenager's job does not last long and he is right back in unemployment. High turnover is associated with a high quit rate on the part of workers; they get lousy jobs, little job satisfaction, little training, low wages, and little opportunity to advance.

Almost anything that comes along may look better than the job they have, so there is a strong tendency for these groups to quit, often to withdraw from the labor force to work in the household, or to go to school.

From the employer's point of view, when he hires groups that he perceives have very low attachment to their jobs and are likely to quit, he feels he cannot offer very high wages since their productivity is relatively low. If he did train them, he would be afraid of losing its benefits. So usually he does not give significant training, offers low wages and is quick to use layoffs. Any time production drops, this is the group that has low skills and low seniority that is most likely to be laid off by the employer. The employers' and the workers' behaviors interact producing with a high layoff rate and a high quit rate.

Groups that have recurring unemployment are those that suffer the highest unemployment rates. Anybody can put up with a single period of unemployment even if it happens to last a long time, but the most severe structural problem is being unemployed every 6 months.

Now, turning to training and placement, what we need to do to get at these structural issues is train people so they have higher productivity, so they can qualify for higher paying jobs, help them with their motivation problems through counseling, help them with the placement process by improving their job search technique. In short, programs must help workers get in the right jobs so that both the worker is satisfied with the job and is productive.

So, the quality of placement is every bit as important as the speed of it. Programs designed to that end need to be substantially increased.

Now, turning to programs that we need but simply don't have. When Don Nichols alluded to dividing the labor market into the high-wage and the low-wage job, and he found that the unemployment in the high-wage sector was very closely associated with inflation, but unemployment in the low-wage sector was not. This means to me that, if we want to use manpower programs to have anti-inflationary impact, we need to substantially increase the number of people who have high skills.

The industrial composition of demand is continually shifting. One industry is overstimulated at one time and a different industry at another time. Also, the geographic composition of employment is continually shifting, so the skill shortage picture is very dynamic. Many of our training institutions, such as vocational education, train for the same occupations year in and year out, regardless of the conditions of the labor market. It is a program designed to have almost a minimum impact on the inflation problem. Employers who have labor shortages try to hire away the labor force of the other employers which leads to inflationary wage increases. If training programs are targeted on skill shortages, employers will not be under pressure to make inflationary wage increases which are passed on in price increases. This is an area in which we have had simply no MDTA programs. The program back in 1962 did have a skill-training component. Don Nichols suggested that we train a disadvantaged worker to fill skill shortages, but that probably is not feasible.

In order to work fast and effectively in preventing skill shortages, a training program usually must start with a fairly skilled person and make a more skilled person out of him or her and then fill the emptied job by upgrading.

We need to focus in the labor market on problems on two ends: The employer's problems, where he has difficulty in finding workers so that we have problem vacancies, and worker's problems which reflect various handicaps.

We ought to tailor our manpower programs not to the whole labor market, but to target them on the inflationary segment of the economy and on the structurally unemployed. The structurally unemployed I would define as those people that for a variety of reasons have excessively frequent periods of unemployment.

The decentralized CETA programs have never made the Federal objectives clear in terms of the desired impacts. The initial CETA program essentially is motivated by the feeling that Washington didn't know how to solve these problems, and so the ball would be thrown to the mayors and Governors. The implicit assumption was that they would know how to solve them.

Well, the mayors and Governors had their own problems and concerns and, since the legislation simply said in general terms to reduce the unemployment of the disadvantaged, there was a great deal of freedom for the mayors and Governors operating these programs.

If the Federal Government is willing to fund programs and have them administered in the local community and it makes a great deal of sense to do so because the different communities face different kinds of problems, and the money really ought to be spent for different program mixes in various areas. However, the Federal Government ought to specify the impacts sought on structural unemployment and they ought to measure those impacts and reward performance. These are not now being done adequately.

If you look at the way large corporations decentralize their operations, there is a bottom line on the profit statement that governs, so the manager is free to operate as long as he makes *x* percent profit, then performance is measured, and the manager is rewarded.

Now, the manpower programs don't have a market test, but we can measure the impacts of training programs on how long jobs last after a person has participated in the program. If we really decide on the Federal level what we want this Federal money to do, we can set up program objectives and trust the locals to take into account local conditions and essentially turn them loose. But if you simply gave them money with vague objectives, you are going to get the solution to the political and other problems that the mayors, Governors, and communities face.

Diagnosing the employment problems of the individual worker is critical. Each individual worker may have different problems. Some have educational problems, some have motivational problems, some have skill problems, some may be in the wrong region, and some may have bad information about the labor market. All of these things are highly individual. For these programs to be effective, we need to have programs that are sensitive to diagnosing and prescribing the right "medicine" for these individuals. That is a very demanding requirement for an administrative program to meet.

Our present programs are simply not facing up to our needs. I would go so far as to say that we are not going to make a significant impact on our structural problems unless a number of things happen.

One, Federal objectives have to be made clear as to what the Federal Government wants both with respect to structural problems and with respect to inflation.

Second, a unified and simplified national organizational structure needs to be set up so that we get effective cooperation between the Employment Service, CETA, and other manpower programs.

I realize the difficulties of doing this, but we are not going to have fully effective operating programs until these changes are made.

The third point is that the regulatory functions that the Department of Labor is concerned with, the EEOC, and also the Environmental Protection Agency and Occupational Safety and Health Administration—these regulatory functions are policing operations and, if you try with the same organization to be both a policeman and render services, you find a great deal of reluctance of private employees to get very close to these programs, and especially since the programs now offer very little to the employers unless they happen to be in a very tight labor market. So it is essential that there be an organizational separation of the regulation. Fourth, a new program needs to be directed at inflationary skill shortages.

Finally, we need a better level of mangement in all these programs. It is sometimes said that the Republicans don't overly believe in Government programs, but they do believe in good management and the Democrats believe in the programs but they aren't much interested in management. Perhaps what we need to do is marry the virtues of both parties.

Representative MITCHELL. I would be agreeable with such a marriage.

Thank you. You have been very definitive in your recommendation and obviously you covered a number of questions, but I do want to take 3 or 4 minutes to make some observations with reference to your testimony and Mr. Wachter's.

[The prepared statement of Mr. Holt follows:]

## PREPARED STATEMENT OF CHARLES C. HOLT

### *Structural Unemployment and Inflation*

Although these hearings are primarily concerned with evaluating policies for reducing structural unemployment, the issues involved can only be understood in the context of the larger inflation-unemployment dilemma. This statement will attempt, in the simplest terms, to summarize what economists now know about both the broad and the narrower issues, including ones of program implementation. U.S. policies are increasingly recognized as far from adequate in dealing with structural problems in our labor markets, and Congress and the Joint Economic Committee are to be commended for pausing at this time to make a fundamental reassessment of our needs in relation to present and potential programs and policies.

Since the second decade of this century, economic understanding of labor markets and wage-price dynamics has lagged behind the practical needs of policy analysis. During that decade, labor economists rejected the oversimplified classical theory as inapplicable to the complexities of the labor market, but only in the last decade has more adequate theory been developing. Our current policy difficulties can be partially traced to the failure of economists to integrate micro- and macro-analysis.

### *1. Inflation-unemployment and demand stabilization*

When aggregate demand exceeds our capacity to produce for an extended period, the inflation rates of wages and prices gradually accelerate. They can be restrained by reducing demand and creating unemployment and slack capital capacity, but the response is very slow and the process painful. Since the economy is subject to disturbances that can induce both inflation and unemployment, such as the OPEC oil cartel embargo, it is important for monetary and fiscal stabilization policies to offset their worst effects. The balanced budget policy, which currently is under debate in Congress, would be economically disastrous. As it was, the OPEC increase in oil prices induced the most severe U.S. recession since the great depression of the thirties. If tax rates had been sufficiently increased and expenditures sufficiently decreased to balance the budget, the ensuing severe depression would have been a disaster—and entirely unnecessary.

The automatic adjustment of real wages will ultimately restore a full employment equilibrium, but the adjustment process works very slowly. One estimate is that 4 years would be needed to reduce disequilibrium unemployment by 50 percent. This long persistence of involuntary unemployment is a powerful argument for active demand stabilization policies by the government. However, because of the connection between inflation and unemployment, there is no assurance that both objectives can always be achieved simultaneously by regulating aggregate demand.

The equilibrium level of employment is inhibited by heavy payroll taxes, myriad government regulations, and paperwork burdens, especially on small businesses. In addition, producer oligopolies and unions probably interact to give the economy an inflationary bias. The overall result in the American economy is chronically high levels of unemployment that cannot be breached even by active and effective stabilization policies. Hence the prospect is that we will have fewer jobs than workers—the only question is which groups will be left out and have neither work nor income.

Exactly why unemployment and inflation respond so slowly to over- and understimulation has been a long-standing puzzle. Empirical and theoretical analysis of sticky wages and disequilibria has underlined their existence and importance. Recent work on allocation by "job availability" suggests that both employers and workers may respond directly to labor market conditions measured by the ratio of vacancies to unemployment in addition to the classical wage allocator. Sticky wages may actually be equilibrium wages achieved through availability adjustments. This new way of looking at labor markets may change our understanding of unemployment. Labor markets may settle down to different equilibrium positions that are equally stable; a high-wage with high unemployment condition could be as viable an equilibrium as a low-wage with low unemployment condition.

With the need for better economic understanding so critical, it is ironic that the government has not organized an adequate research effort to support its analysis of remedial policies.

### *2. Targeted employment programs*

When aggregate demand is low relative to the number of people who want to work, then many people remain unemployed and others, because of discouragement in looking for jobs, drop out of the labor force. The groups that bear these burdens most heavily are those that experience frequent spells of unemployment. Their jobs do not last long because the probabilities of being laid off or of quitting are both high. In general, these are people with low seniority, they lack experience and skills, and they are confined to occupations and areas where wages and work quality are low. They usually are young, women, or minorities. Employers anticipating high quits and short job tenure for these groups try to protect their own interests by offering little skill training and relatively low wages. Since employer investments in skills for these workers are low, firms are quick to lay off workers when production declines. These workers respond to low wages, little training, and high layoff risk by quickly quitting when slightly better jobs appear or when household work is needed—such poor jobs come on the market frequently.

When an economic downturn occurs, these same groups tend to be laid off first and they suffer unemployment disproportionately. Under these circumstances, targeted cyclical programs—either public service job creation or subsidized private employment—are fully justified to improve income equity and to reduce expenditures on income maintenance programs that otherwise would be needed. Because such programs can be targeted on slack occupations and regions, inflationary impact is minimal.

### *3. Training and other manpower programs directed at structural unemployment*

The high unemployment groups (with the exception of the aged) usually do not have unusually long durations of unemployment. Hence, to be effective, structural improvements must reduce their quit and layoff rates to levels closer to those of prime white adult males. To do this requires increasing the skills and productivity of the target group so that they can qualify for higher paying, more satisfying jobs; matching their abilities more carefully to job requirements; lowering discriminatory barriers to the better jobs; increasing security against layoffs; and improving work attitudes. These things can be done by institutional education and training and by Employment Service counseling and placement efforts. But most training is done on the job by other workers; so the active cooperation of employers and unions is essential. While there has been some success with on-the-job training, the government-employer link still is weak, and manpower programs need to be more closely tied to work experience.

In response to the recession starting in 1973, the CETA program has focused primarily on countercyclical employment programs with correspondingly less effort devoted to training, etc.

### 4. *Training and other manpower programs directed against inflation*

The desires of business firms to increase profits through price increases, especially when the backlog of orders is high, and of workers to increase earnings through wage increases, especially when job vacancies are high, create a steady inflationary pressure on the wage and price levels, pressure that is normally restrained by economic slack in the form of unemployed workers, unused capital capacity, inventories of raw materials anf finished goods, and housing vacancies.

When the labor market is segmented occupationally and regionally, rather small groups of workers in an area have the necessary skills for the better paying occupations. In this situation a substantial increase in aggregate demand tends to induce skill shortage bottlenecks, which trigger employers to compete through the sharp wage increases for the limited supply of skilled workers. Often too hiring standards are lowered, which decreases productivity and raises labor costs. Thus the lack of skills that contributes to structural unemployment also makes the economy more inflation prone as wage increases are followed by price increases.

When the response to inflation is to increase unemployment, it is induced primarily among the unskilled workers in order, paradoxically, to restrain wage increases in the skilled occupations and regions that are experiencing excess demand.

To resist inflation, the government clearly should organize training at high skill levels and other new programs to address the skill shortage problems of employers. Currently we have programs directed at workers with employment problems, but we are doing virtually nothing about the hard-to-fill vacancies that contribute to inflation.

### 5. *Current programs are inadequate*

The heavy taxation of earnings relative to capital and the subsidization of capital investment both favor the substitution of capital for labor. Also many regulatory and tax programs inhibit the formation of new businesses that would lead to employment opportunities. Our inadequate antitrust and antimerger policies do little to restrict growing economic concentration, which contributes to inflationary pressure.

Counter cyclical monetary and fiscal policies and the CETA jobs programs have contributed to employment stability, but the threat of inflation has prevented the attainment of labor markets that are tight enough to dissolve structural problems.

CETA, Vocational Education, and Employment Service programs in the training, counseling and placement areas have been inadequate in scale and effectiveness to make a dent in structural unemployment. The "decentralized" CETA legislation never made federal objectives clear in terms of desired impacts and has never set up a sampling system for monitoring and measuring the impacts that did occur. Instead, the fragmentation of CETA titles grows, eligibility is ever more restrictive, and the operating people in the field become increasingly harried and frustrated by federal rules and regulations. Diagnosing the employment problems of the individual worker and arranging counseling, education and training to meet his or her unique needs gets crowded out in a fragmented, bureaucratic maze of rules and procedures in which no one has adequate time to think, plan, analyze, and manage. That these often poorly administered programs still test out to give healthy benefit/cost ratios indicates the high potential contribution of manpower programs.

Not only are programs aimed at skill shortages—which would be a natural area for cooperation with employers—absent from the current program mix, but the operating structures of CETA and the Employment Service are inherently weak in developing cooperation with employers. Business firms naturally shy away from programs involving excessive red tape and regulation. The Committee for Economic Development has found that imaginative employers have important contributions to make to structural employment problems even when their motivation is primarily altruistic.

Inflation and structural unemployment will persist until structural reforms are achieved. Since these objectives are of paramount importance, we must improve the effectiveness of our employment and training programs and then fund them at an adequate level. The potential is great, but much experimentation, imagination, good management, improved legislation, and research are badly needed.

### *6. Critical deficiencies in organization and administration*

The above problems will not be solved and hence structural unemployment and inflation are likely to persist until the following changes are made:

(1) The federal objectives of reducing both structural unemployment and inflation are clearly spelled out, and good performance at the operating levels measured and rewarded.

(2) A unified and simplified national organizational structure which integrates the service delivery operations of CETA, the Employment Service, Vocational Education, and the other manpower programs, and, within the constraints of meeting federal objectives and performance standards, assigns administrative responsibilities to suitable levels of the federal-regional-state-county-city-prime sponsor-service delivery system is achieved. Functions and responsibilities should be parceled out and the structure left in place long enough for everyone involved to learn how to make the system work. Once reorganized, erratic changes in programs and regulations should be minimized as a matter of policy. (The fragmented organizational structure and maladministration of manpower programs that we now have are totally inadequate responses to the needs of the country. Programs are largely run out of Washington bound by laws and regulations that usually are written by people who have never administered operating programs. The result is that morale and productivity currently are at low levels. Needing and wanting results and even funding programs will not suffice, if the organizational structure, administration, and regulations consistently defeat effective action at the working levels. Only if a great deal of power to act is assigned to the local problem-solving level, can these programs be efficient in meeting federal objectives and meshing with the legitimate local agendas of governors, mayors, and communities. Ultimately the programs must be responsive to the needs of the individual worker and his/her employer that simply can't be done from Washington.)

(3) The administration of regulatory functions of EEOC, EPA, OSHA, etc., are unified, made consistent, and separated from service delivery; otherwise essential employer cooperation cannot be attained.

(4) The organizational structure is designed to promote and facilitate problem solving and joint efforts involving not only the various levels of government, contractors, and employers, but also unions and community organizations. Federal funds can be responsibly and efficiently spent at local decision-making levels, if federal objectives are clear and program impacts are monitored to make sure that the objectives are met. The President and Congress should take the attitude that they don't care how the locals do their jobs so long as they get the results the country needs to reduce structural employment problems and inflation.

(5) New programs aimed at skill shortages are designed and funded to help combat inflation and to motivate the participation of employers in terms of their own self-interests. Active cooperation with private employers cannot be built on appeals to altruism alone. Employer cooperation has not been a problem in local labor markets that have low unemployment rates, but that occurred because the OJT programs have actively helped employers with their recruiting problems.

Implementing these major changes and the increased funding that ultimately will be necessary, once efficiency is attained, will only occur when there is general recognition that we have no other choice but to face up to the structural problems in the labor market and the critical economic problems that flow from them. The Joint Economic Committee, in writing the report requested by Congress, has a unique opportunity to crystallize the manpower policy issues and to point the way toward their solutions.

Now is the time to think big and constructively, because the economic and social costs to the nation of continued inflation and unemployment are enormous. If at this time the American people are in a mood not to trust their governmental institutions with increased responsibilities for solving structural problems, so be it. But the resulting costs of inaction will continue to be high—there is no free lunch. Time can be well used to address the organizational and administrative problems, which must be solved first anyway.

NOTE.—The author has available a listing of references that bear on the points discussed above. It is available on request from: Bureau of Business Research, University of Texas, Austin, Tex. 78712, telephone, 512-471-1616.

Representative MITCHELL. The first observation is it is most distressing to me that somehow or other we have turned the fight against inflation to what amounts to a holding steady or slight increase in the rate of unemployment. That seems to me to be an analytical point.

We have talked about the work ethic. That has been a part of the backbone of this Nation and suddenly we reach a point now where we say 6 percent is really acceptable unemployment, you will never get below that without increasing inflation.

I don't want to take that kind of pessimistic attitude. I think we can have every man and woman who wants to work working in this country without fanning the fires of inflation. We are focusing so much on inflation, that we are treating the unemployed individual as an expendable item, and I think that is wrong.

I think this attitude is in absolute contradiction to what this Nation stood for.

The second observation—I suppose I have broken the law on occasion or at least bent it in the sense that I go home every night, and people pound on my door looking for jobs, and I will send them to jobs whenever I can. Many jobs are with small contractors, and I find that they are paid $2 an hour. That is less than the minimum wage, but the people that I send to those jobs stay on.

I am making this observation because I tend to look askance at statements that say that people will not work for low wages.

Maybe Baltimore is a unique situation, but I know darn well that for any person I can get a job at $2 or up in Baltimore, they grab it. I don't think my city is that unique, and I think it is unfair to maintain that people won't work for a certain wage.

Certainly the structurally unemployed will, because they don't get unemployment compensation. They want something.

The third is with reference to the private sector. My background has been in public service. I ran a CAP agency at one time when we were under the old jobs program, and I don't hesitate to say before members of this committee and these witnesses, that by and large, public jobs are created because of the failure of the private sector to address structural unemployment and other types of unemployment.

Now, I know there may be some exceptions, but, frankly, the National Alliance of Businessmen—I think it is a hard process for it to put itself back together again, and I hope it does. I think it has a contribution to make, but I am convinced that much of the structural unemployment that we now see is based upon the private sector's unwillingness to tackle this social problem with the same zeal as they attack the problem of making profits. This brings me down to my last observation and one quick question.

We have skirted around or talked around all of the various reasons for black unemployment and, as I said before in one of our previous committee meetings, I think the matter of racism, or racial discrimination, is there. I believe it is a normal tendency when they have a lot of people asking for jobs and the guy at the hiring gate is white, for him to pick up the white person first.

Perhaps that is just natural and normal, but I don't see how in the world we can avoid treating this factor of racial discrimination. I think it does contribute to the structural unemployment and cyclical unemployment that is experienced by many minorities.

Now, having got that off my chest, I would like to note I have got it off without giving anybody an opportunity to rebut me and I deliberately did it that way.

I would like to put one question to all of the panelists.

There has been a lot of discussion about the relevance of wage rates to labor market behavior. Mr. Johnson, I think you alluded to this. You inferred in your statement that certain conditions, such as rigidity of wage rates, must be present in the labor market in order for job programs to be effective.

I would like to get a comment from all of the witnesses on this. I would like for you to expand on the different types of wage rigidities which impact on structural unemployment programs, hoping that this committee can get a kind of precise view of where you agree and disagree, so that we can arrive at a point with reference to just that one small problem area.

All four gentlemen, please.

Mr. WACHTER. May I start off by addressing your question in an indirect manner by going back to your original statement?

Representative MITCHELL. I thought you would find the opportunity.

Mr. WACHTER. I hope you agree with me on this.

I am not suggesting at all that society should maintain a posture that 6 percent unemployment is the best we can do.

In fact, the stress of my argument was precisely the reverse; it is with the current policies that we will be stuck at 6 percent unemployment in order to maintain stable inflation. In other words, if unemployment is reduced much below 6 percent, with the current kind of CETA program that we have, or at least the CETA program we had a year ago, the result will be accelerating inflation.

I think that we can make substantial progress in bringing down that 6 percent unemployment rate, but it cannot be done in the context of expansionary monetary and fiscal policy.

The stress of my argument was that when we get close to full employment—in fact, even before that—we should begin to focus funds, not on those parts of the labor market that are already well heeled, but on the pockets of ongoing high unemployment.

I am not at all satisfied with the 6-percent unemployment rate; I am greatly distressed by it. My fear is that the current policies won't allow us to go below 6 percent.

Representative MITCHELL. My problem is that what may be a valid theoretical approach in terms of the relationship between unemployment and inflation has been perverted to the point that it is now a slogan which states one cannot reduce unemployment without having an impact on increasing inflation.

That is my problem. I understand what you are saying but your theoretical frame of reference has been distorted by far too many people to mean that it is all right if we stay at 6 percent in order to fight inflation.

Mr. WACHTER. I think that the policies that many of us around this table are recommending, is that as we move toward a world of "fiscal conservativism," we should not adopt 6-percent unemployment as a target.

What we have to do is to marry fiscal conservativism with the notion that structural policies can work to lower unemployment in a noninflationary context. But we need structural policies to lower that unemployment rate. Presumably, the old cyclical policies will be voted down as being inflationary.

Representative MITCHELL. Could the panel address my previous question?

This is an intriguing area of discussion, but my colleagues have other questions.

I would like to hear your comments about the structure of wage rates. I would urge that you respond to that in order to give Congressman Brown and Senator Javits an opportunity to ask questions.

Could you hold your response for just a moment, Mr. Holt, because I think it is imperative that we give an opportunity to other members of the committee to get in some questions.

Are there any comments on the question that I put to all of the members of the panel; that is, the relevance of wage rates to labor market behavior and the various types of rigidities?

Mr. HOLT. Well, George Johnson brought the concept up first. I would like to say something about it.

Mr. JOHNSON. No; actually Don Nichols brought it up first, but what Don Nichols' view was is that there are some groups in society, some groups in the labor market, who are in labor markets which, if you increase their employment, reduce their unemployment, does not add significantly or at all perhaps to the inflationary pressures; that is, that there are some groups in the labor market whose wage rates, the wage rates for their jobs, for a variety of institutional reasons, are geared to other workers.

Now, some of those institutional reasons would include, of course, minimum wage legislation. Others would include unionism, behavior by employers such as they don't want to pay wages of $1.15 to some people in a market.

I really am the one who stressed the importance of wage rigidity and this is consistent with what Don Nichols was saying—that employment policy again will be most effective if it is geared to those individuals, to those groups who are not in the mainstream of the inflation process.

Representative MITCHELL. Other comments?

Mr. NICHOLS. Yes.

As an analytic point, George Johnson is right that if you try to increase the demand for employment regardless of the group, part of it will go into wage increases, part of it into employment increases.

As an empirical point, however, I was arguing that in the low-wage occupations, it appears that you can increase the employment level without a significant wage increase. Now that is an empirical statement. The data seem to indicate that you could increase employment without running into wage pressures.

But as an analytic point, George Johnson is right that it has to be some combination of these two. The possibility of reducing unemployment with structural programs is best in those markets, where it is possible to increase employment without increasing wages. That is the proper analytic point.

I made the point that the data indicate that it is possible to increase employment in low-wage occupations without significant effects on wages.

Representative **Mitchell**. Mr. Holt.

Mr. **Holt**. The neoclassical theory says the answer to the unemployment problem is that when an unemployed person will bid down, wages will continue to fall and ultimately somebody will hire him.

It has been a puzzle kicking around in economics for 30 or 40 years as to why wages are so sticky and why this adjustment process does not occur effectively.

We know that unemployment is not a self-solving problem, otherwise we would not be having this session so a lot of recent work in economic theory is essentially taking that disequilibrium and simply saying that it does not happen and then trying to go on and understand what this disequilibrium economy looks like and how it works.

Some very recent work that I have been involved in indicates that people in the labor market may be not responding to the wage rate that is offered them as much as the availability of jobs and that in fact both employers and workers may be responding very directly to conditions in the labor market, how long it takes to find a job which influences their tendency to drop out and whether they take jobs and so on and to the extent that this is true, what we may have been interpreting as a disequilibrium situation that ought to adjust, in fact, may be an equilibrium situation.

There may be a whole series of different equilibria in the economy that are equally stable. This is an example of the need for a better theoretical answer. We are basically using the theory that goes back to the last century and it does not work in the labor market because of its complexity. We badly need a lesser deal of theoretical and empirical answers to that question.

Representative **Mitchell**. Thank you.

Mr. Wachter, did you have a comment on that?

Mr. **Wachter**. I think I have been over it. I will pass.

Representative **Mitchell**. Congressman Brown.

Representative **Brown**. Thank you, Congressman Mitchell.

Both Mr. Holt and Mr. Wachter use the analogy of marriage, and I would like to keep both hands above the table and propose to you that you might look at a program that I have put into legislative form that I think cares enough to meet the Democratic standards, although I must say that I resent that insult that the Republicans don't care.

I think it is direct and complicated enough to be operable under a GOP standard, and for Congressman Mitchell I want to say that we resent that part of your comment, too.

Let me say that I want to make a general comment and then ask a couple of questions, too.

I want to jump to Mr. Holt about a couple of things. I would argue perhaps that the OPEC problem was not a demand problem.

There was plenty of demand at the time that the OPEC situation occurred. It was a tax on all of us until we killed off demand and killed off job opportunities.

I hate to use any term to define myself as an economist, but I have the capacity as any good politician, as I think any intelligent economist does, to move from one category to another as the circumstances change economically and socially and politically.

I have the feeling that if we could reduce the burden of taxes, regulation, and a lot of other things—not that we don't need the tax money for certain good purposes, not that we don't need the regulation for certain good purposes—we could hire more people in our economy and we could improve our economy by modernizing and doing an awful lot of other things that we are not now doing in the private sector because of what the public sector is taking away from the private sector in the way of discretionary capital to make those changes.

I have got a whole long list of things that I would like to do in that regard, but I don't think that is the function of this hearing.

We address that issue in other hearings and so in a way I disagree with you and in a way I agree with you.

Now, having taken that firm stand, let me just say that I think one of the problems is that structurally unemployed youth and structurally unemployed women and structurally unemployed other people are generally not covered by unemployment compensation.

The skilled employee can take time in finding a job because he has full qualification under unemployment compensation to find that job, so the fact that he is out of work for 24 weeks, he is not quite as desperate as the unemployed young person who does not qualify for unemployment compensation.

I just want to ask this question: As the young move in and out of the job, Mr. Holt, you seem to be implying that their time between jobs is shorter.

If that is in fact what you are saying, that does not seem square with the 1978 statistics in which 36 percent of unemployed youths were unemployed for 15 weeks or longer.

You seem to be talking only about those youths who are measured in the labor force, but there are many discouraged people whose unemployment may be 50 weeks a year; they just are not making it very often into the ranks of the employed.

I would urge you to check into that and see if you would not at least in some slight way modify your position.

So much for that question.

I won't press you for an answer unless you want to comment.

Mr. Holt. Well, I agree with virtually all you said. I intended no insult to everybody but rather a joke.

Representative Brown. We are easily insulted and easily accept it as a joke.

Mr. Holt. I was not talking about the activity of the Congress so much as the administrative agency at that point.

Your interpretation of OPEC, I think, is quite right.

Representative Brown. I don't want you to talk about that.

Mr. Holt. In examining the duration of unemployment statistics, you need to look at the duration of unemployment for the other groups in the labor market.

My impression is that youth unemployment tends to be somewhat shorter usually than the average unemployment of other people.

That is not to say that when you have a very slack labor market, some young do have in fact long durations of unemployment, but if your want to explain why, for example, when the national unemployment rate went down to something like a happy level of 4 percent, black teenage girls would still have an unemployment rate of the order of 31 percent. Most of the explanation of that high rate of unemployment would be associated with the high turnover of that group and going back to Congressman Mitchell saying that they would grab a low-wage job quickly.

I think that is true, but I think you would be interested in following up those jobs and seeing, after the person had been in the job 6 months, how long he was there.

When you need a job desperately, you take it, but you may very well not stay in it very long if the income is not adequate to support the family.

Representative **Brown**. Well, I still think the labor market is not adequately addressed by the statistics which we have available to us, and that is the problem.

Mr. **Holt**. What you are saying about withdrawal is certainly true. About half of the people that quit a job go into unemployment and the other half of the people leave the labor force, and half of the people roughly that are laid off, about half of them leave the labor force, so that there is a tremendous flow back and forth between employment and unemployment, but there is an equal flow out of the labor force and back into the labor force.

Representative **Brown**. I would agree that there is that flow both ways, but I would disagree that it is equal.

I think there are those people who are structurally unemployed, who will never get out, and we ought to try to address some of those people. They are a very different breed of cat from the guy who is a welder and he is laid off his welding job after 5 years because of the temporary recession and he can afford to take 24 weeks to look for a job because welders are always pretty much in demand.

Mr. **Holt**. That is true, but that will turn up in the turnover list.

Representative **Brown**. Let me move on to another question and I want to place this question and make a list of the things that it seems to me you all have been saying and ask if you have anything to add to it or to take away from it, and then I will conclude.

It seems to me that as we have moved from an industrial to a service society, we should have been able to do better in dealing with the structurally unemployed. We have less linotype operators and more typists. In other words, the skill level of a highly technical society is lower and in another way we have moved from the French chef to the McDonald's hamburger cook. What I am saying is we have moved from the linotype operator to the McDonald's hamburger cook. We are a service society as opposed to an industrial society and the jobs tend to be simpler in the nature of their work and yet we still have just a very basic problem of structural unemployment.

Now I think that does tend to confirm to some extent what my friend, Congressman Mitchell, says about racial bias and some other things. I think there is another factor, however, that I worry about—well, a couple of other factors. One is this sort of sustained social development that we have which is beneficial to our society, but in some ways does raise the wage at which you can get somebody off of that social sustenance program and into the work force.

Also, there is the problem of a certain stigma attached to certain jobs and this prevents movement from unemployed to employed. Jobs, such as domestics, janitors, garbage collectors, even housewives, all are very important to our society, but now possess a certain social stigma that prevents people from moving into these low-paying wage areas as was once the case.

I make that comment without further editorial asides except that it is, I think, a factor.

So the key ought to be a concentration on training. I want to cite a final example, and that is, I ran into the other day a very fine-looking young man, healthy, bright in his conversation, attractive, who had been trained by the city to be a city fireman and had run out of his money for CETA training. The only trouble was when the city finally hired firemen, they had trained so many to be fireman they could only employ about half of them. It seems to me the joke is on him except it is not really very funny to him.

That is where it falls down. It is a sinister, enervating and a cynicism-making kind of problem.

Finally, let me list what I have gotten out of this hearing so far and ask if you would agree with this or add anything to it. This is the question and I apologize for going into my preliminary comments.

I want to say something to you, Mr. Wachter, about tax credits being successful. I run a small business and my accountant discovered I was eligible for the employment tax credit. I know that is Senator Bentsen's program and I hate to hit him with that fact, but maybe General Motors has a tax lawyer who knows about the tax credit but in most small business and in my small business we didn't know it until the tax man said, "Oh, yeah, you hired two additional people and you get a tax break."

I really think that you may be whistling Dixie a little on that one.

The list I have says this: Fiscal and monetary policies to expand jobs are important; however, it is not an issue when dealing with the structural unemployment problem. We all agree that something ought to be done to make the general economic condition good so people are looking for jobs.

The most significant issue is that training is the key to moving a person from the structurally unemployed into an employed status.

Another item I get is that the private sector involvement is also vital as well as public sector, which fills in the gaps in the private sector when we have the downturn of the economy.

Third, that you have to aim the program to the structurally and socially unemployed through the measure of unemployment compensation benefits. For the ineligible employees, this measure ought to be the significant measure of a program for those folks that we are worried about. Also, that you have an effective intermediary to match up the unemployed to the job which is available. Sometimes that requires a social engineer, teach him how to apply for a job, teach him how to dress when they have never had any experience, but nevertheless somebody who really has the sincere capacity to do that.

With all due respect I don't think that it is often the U.S. Employment Service who sits there and mostly says, "Next."

Then that the program really ought to apply to all wage levels because the structurally unemployed are primarily low-wage employees, limited-skill people, but there are those rare cases which we discussed earlier where you are dealing with the Boeing employee in Seattle where you really have to try to see if you cannot have a program that can get them out of their sort of peculiar unemployment.

Finally, that the program should be direct and easily administered and it is as nonpolitical as you can make it.

Would you have anything to add to that? Would you disagree with any of those, and if so, please advise.

Mr. Wachter. Let me start off by agreeing that a list focusing on training is the key. I think it is right on target in terms of structural policies.

I was not suggesting that we increase the legislated market wage. With structural policies the cost of being unemployed would increase due to the increased skill of disadvantaged workers. The increase in skill would cause market wages for these groups to increase without inflation.

Representative Brown. Do you have to do that before he enters? Could you not connect a low-skilled employee with the job?

Mr. Wachter. Yes.

Representative Brown. Then in some way encourage that connection so that he would then be trained on the job for the job.

Mr. Wachter. Precisely, and that is why I argued that we had to move away from public sector training to private sector training because that is where the new jobs are going to be. The public sector is not expanding currently in terms of jobs. The training should be located as close to the growing job opportunities as possible.

Representative Brown. So in any newspaper plant I don't train him to be a linotype operator, but rather, train the person to be a stenograph operator so they can type the tape that goes into the process that we use now and then keep them on the job after they have that training.

Mr. Wachter. I would not be opposed to a firm training 3,000 welders when they only needed 35. If they have a program for training welders efficiently that is what is needed. Other firms who need welders can hire the extra workers.

Representative Brown. I, in turn, am not opposed to training 6 firemen to fill 6 rather than 24 jobs.

Mr. Wachter. That is right. The only area I disagree with you, but I think that it is a terminological disagreement, is over the importance of focusing on the limitations of monetary and fiscal policy.

If we are willing to take seriously the notion that we don't want accelerating inflation, then it is important to locate the unemployment rate cutoff, whether that be 6 or 4 percent. At that point, the economy should move away from any further fiscal or monetary stimulus and focus on the creation of more human and physical capital——

Representative Brown. I think that is vital, too, but I think if we play around with this hearing, we will all go off chasing butterflies and not talk about what we came here to talk about.

Mr. Nichols. Let me disagree with one thing and that is the emphasis on training. I agree that training is important, but I don't think that this should be taken to mean you don't receive training on a PSE job. The data that we now have of people who have passed through our program indicate that people who have been on the PSE jobs have as big an increase in their earnings as the people who have been through the training programs and the jobs they get are as good and last as long.

This would support PSE programs as a way of giving them the basic work skills. I just want to say that your emphasis is that training is the key should not mean in a programmatic sense that we must do away with the PSE.

Representative Brown. I don't want to leave that impression either. I think that public service jobs need public service job training.

The fireman, for instance, I don't know where he is going to go to work and find a private job although it is not impossible, but as a city fireman the program did not work right. Frankly, the downside of that does not seem to me to be as great for the municipal training program administrator as it might be for the private sector training program administrator, but I won't sustain that argument beyond just observing it.

I think it needs to be very carefully managed in each case and train the person for the job that really exists whether in the public or private sector, and I think there may be very many jobs in the private sector.

Mr. HOLT. I would agree with your list, but my only qualification would be to put more stress when you talk about more training for all these levels. Currently we know that to increase the stimulus to the economy much below 6 percent we are going to get an inflation problem. The American people in terms of response to policy and so on indicate that inflation is a very high priority.

So if you look at the Humphrey-Hawkins objective in 2½ years and getting down to 4.5-percent unemployment, that is simply not doable unless we decrease structural problems.

I would like to focus on the two facets of the structural problem. We don't have enough funds to train everybody and deal with the whole labor market, so we need to focus on the inflation and disadvantaged workers. We can do both of those and we are currently doing only the latter.

Mr. JOHNSON. I just would like to disagree with the list and also with Charlie Holt to the extent that you cannot treat everybody on a training system. The engineers in Seattle, for example, or the teachers who didn't get good teaching jobs and whatever. You cannot do everything. I think that this is an ideological assumption.

The reason we ought to focus limited resources on the low end where the income distribution is because the primary questions that we have been looking at have to do with the effect of these programs on unemployment rates. I think that especially training programs probably have a much more important impact on the opportunities of individuals in their later lives not to be employed, but rather, to earn decent incomes. I really do think that you don't want to try to cover everything because the system is such that the people who will be covered will be the people who don't need to be covered.

Representative BROWN. I support that, but at the same time our big problem list, as we all know, as my opening statement indicated, in this structurally unemployed area——

Mr. JOHNSON. I say they ought to be separate programs. You don't want to mix up too many activities because we just simply may lose sight of what I think is more important.

Representative BROWN. Unless the program itself can do it soundly, I would agree they ought to be separated, but I modestly said I devised a program that may be able to a little bit more of that and that is the marriage that I am trying to make here with my friends on my left.

Mr. HOLT. I would by not putting it in the same program. I think that you need a new program.

Representative BROWN. I will send it to both of you and see if you can agree.

Representative MITCHELL. Senator Javits.

Senator JAVITS. Congressman Mitchell, I shall be very brief, but I did come this morning to remind the committee that according to an amendment sponsored by myself, the committee is asked to report by Public Law 95-524, adopted October 27, 1978. That law asks the committee to report expressly on this subject which we are discussing in this hearing on or before March 1, 1979. I would urge that the staff deal with that particular subject at least by that date or, at the worst, in our report which is due on March 15 anyhow.

It is our own Employment Act of 1946, which we amended that way.

I have just one factual question to you, Mr. Johnson. I am sorry I was not here all morning. I think the testimony has been very useful. As you all know, I had a lot to do with the legislation of the CETA program, but when you speak, Mr. Johnson, in your prepared statement of "my analysis" and then go on to draw your conclusion.

My staff wondered whether that included an analysis of what has happened under the law as we amended it making CETA jobs less attractive or was that an analysis of the old?

Mr. JOHNSON. No; it was not an analysis of specific jobs programs, but rather, of the underlying behavioral assumptions by which one would come to those conclusions.

Senator JAVITS. Second, I would like to ask Mr. Nichols whether he has taken account in his statement of the fact that we mandated a quotient for training which by 1982 goes up to about one-fifth of your appropriation in respect of CETA jobs. We have actually mandated that in the law. Did you take account of that in your testimony?

Mr. NICHOLS. I don't think I criticized it in any way.

Senator JAVITS. No; I say "take account of." I didn't say "criticized."

Mr. NICHOLS. My analysis dealt with occupational groups, not programmatic.

Senator JAVITS. But it is a fact, is it not, that we have provided a very large amount for training specifically?

Mr. NICHOLS. Yes.

Senator JAVITS. And that that is a great improvement in the CETA program, isn't that true?

Mr. NICHOLS. I agree, Senator.

Senator JAVITS. Turning now to Mr. Wachter, his testimony interested me greatly because of his conclusion, which is that we can have a very grave limit with what we can do with fiscal and monetary policy and that, therefore, we have to have some other way—that is correct, is it not?

Mr. WACHTER. Yes; that is correct.

Senator JAVITS. And this is another way, is that correct?

Mr. WACHTER. Yes.

Senator JAVITS. Do you or any of the others have any suggestion for what we could do other than this kind of a CETA employment program which would give us another outlet, another opportunity? We have tried now tax indulgences, which Congressman Brown has spoken of. We have tried CETA, of course. What else can we do which would give us the same noninflationary opportunity to deal with heavily impacted unemployment?

Mr. WACHTER. I think a couple of programs I would advocate, some of them that you mention, vastly improve the program. I think we should do more than that. I think training really is the key. The remaining part of the CETA program, especially for the countercyclical relief, has been, if anything, counterproductive.

I would also say that the new job tax credit, if given more of a chance, might prove to be successful. I think that there really are some possibilities, whether it be done through a tax credit to workers or a voucher given to the disadvantaged workers. I think that has not been explored very much and has tremendous potential. I think we need to do more——

Senator JAVITS. I noticed with great interest you said, Mr. Wachter, in your prepared statement—do you want to follow with me or I will read it to you: "In the context of a slowing economy, a drastic reduction of PSE slots may again be contracyclical."

In short, we now confidently expect the slowing of the economy; so, isn't it a fact that we had better have something better to install in its place than to consider the displacement of the PSE program?

Mr. WACHTER. Yes; I think this may not be the most appropriate time to be making some of these adjustments in the CETA program. I would prefer to see a CETA program, over the long run addressing structural issues. The level of funding should be more or less constant and not so up and down to meet cyclical needs, because the real problem which is structural exists during good times and bad times.

Senator JAVITS. Of course I agree with you and you know that has been my big campaign, although I realize the relief content to the northeastern cities. The fact is that the cities—and my own city of New York is a very good example—would have been paralyzed without title VI. Countercyclical or not countercyclical, it is just another way of skinning the cat.

I have no illusions about it and will not try to explain it or beg the question in any other way. That was simply a going piece of apparatus; to wit, the CETA program, which enabled you to soak up this great deficiency in municipal workers to carry on these services, but as to the rest of it, I thoroughly agree and I will dedicate my utmost efforts to the structural part of the program.

That is what really counts and I would be very much obliged to Mr. Johnson for noting what will be a very real fact.

As ghastly as the minority unemployment of youth, it would be much worse if we didn't have some kind of a program to install even if it is not the optimum.

Now those are the points which I wanted to make, gentlemen, and anything you can do to help us would be, I think most creative. Do any of you have any suggestion as to installing better or other programs?

Mr. Holt said perhaps elevating our training to higher levels of employment, which interested me very greatly, and I will do my utmost to implement any effective suggestions. I wanted you to realize our problem, which is that you cannot beat something with nothing and that that is daily.

You know, these people who have got to do something everyday, it takes us time to work these things out.

Mr. WACHTER. I wanted to add two other comments. The first is that we have been dealing solely with labor market programs. There are a whole host of remedies outside the labor market. One of them I mentioned specifically in my prepared statement is increased physical capital accumulation would be a big help in lowering structural unemployment and raising market wages of individuals. The rate of productivity growth in this country has been dismally low for the last decade. Much of the problem orginates outside the labor market.

The second comment is to encourage exports as a way of increasing employment.

Senator **Javits**. It is a big baby of mine. I just did a big roundup on productivity on the Senate floor the other day. Believe me, I thoroughly agreee with you and we will try to keep our eye on all those balls.

I thank you all very much. I am sorry that I didn't hear the rest of what you said.

Thank you, Congressman Mitchell.

Representative **Mitchell**. Gentlemen, of course we are appreciative of all your contributions. You have been very patient with us. This has been a lengthy hearing and it has been indicative of our intense interest in this area.

Thank you very much for your suggestion about a marriage and other intriguing suggestions.

[Whereupon, at 12:35 p.m., the committee recessed, to reconvene at 10 a.m., Wednesday, February 21, 1979.]

# THE EFFECTS OF STRUCTURAL EMPLOYMENT AND TRAINING PROGRAMS ON INFLATION AND UNEMPLOYMENT

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WEDNESDAY, FEBRUARY 21, 1979

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
*Washington, D.C.*

The committee met, pursuant to recess, at 10:05 a.m., in room 6226, Dirksen Senate Office Building, Hon. Lloyd Bentsen (chairman of the committee) presiding.

Present: Senator Bentsen and Representative Wylie.

Also present: Louis C. Krauthoff II, assistant director-director Special Study on Economic Change; John M. Albertine and M. Catherine Miller, professional staff members; Katie MacArthur, press assistant; Richard D. Bartel, professional staff member; Special Study on Economic Change; Mark Borchelt, administrative assistant; and Mark R. Policinski, minority professional staff member.

## OPENING STATEMENT OF SENATOR BENTSEN, CHAIRMAN

Senator **BENTSEN**. The hearing will come to order.

We are fortunate to have with us this morning—and I do want to emphasize "fortunate"—members who will testify, some very distinguished members, Mr. John Palmer, senior fellow, the Brooking Institution; Isabel V. Sawhill, director, National Commission for Employment Policy; Daniel Hamermesh, professor of economics Michigan State University; Peter Doeringer, professor of economics and acting director, Regional Institute on Employment and Training Policy, Boston, Mass., and Frank Schiff, vice president and chief economist, Committee for Economic Development.

We will proceed, and I am hopeful that we will have some members here this morning. I am one of the very few who was in here yesterday, as I lived nearby. I am very appreciative that you who had a difficult time getting here were able to make it.

Our economic system has produced a record number of jobs, over 3 million during the last 13 months, but too many Mexican-Americans, too many blacks, too many young people, and too many women remain jobless and without hope of participating in the mainstream of our economic life.

I don't know of anything more denigrating than to tell someone they have no productive role to fill in society. I don't know anything that turns them off more.

Economists call these people structually unemployed. That is a cold, bloodless, clinical term which really does not capture the human dimension of this difficult national problem. The structurally unemployed are Americans who cannot find work in bad or in good times. They are forgotten Americans. They do not want welfare, they want only the opportunity to become full participants in our economic life.

We can't afford to waste those resources. Even if you took the most conservative view, the inability to find a place for these folks to participate and contribute is one of the greatest wasteful extravagances that we have in this country.

We have to exert our best efforts to implement manpower policies which help the most people with the resources available.

Through bitter experience we have learned that standing back and throwing money at people and programs does not guarantee their effectiveness.

Unfortunately, we also are in an economic situation where inflation puts a heavy price on our efforts. Congress owes it to the American taxpayer to provide the best programs we can design with the least cost.

In addition, we know that these structurally unemployed eventually must make the transition to the private sector, which provides four out of five jobs in our economy.

That is one of the things to which I want you really to direct your attention. Tell me what happens after we go through that phase of training, whether it is the public sector or the private sector. Tell me what happens to those people.

I authorized the legislation passed by Congress in 1977 to establish an employment tax credit. I did so because I felt then as I feel today that our country would be better off if Government were to encourage private industry to establish long-term productive jobs rather than to pay people not to work.

I believe Mr. Hamermesh gave me that idea, if I remember rightly, and I think that fell on pretty deaf ears generally.

Was that in 1975?

Mr. HAMERMESH. Precisely.

Senator BENTSEN. I want to give you full credit now.

Mr. HAMERMESH. Thank you.

Senator BENTSEN. To have the private sector as well as the public sector involved means we have to have a variety of approaches. Henry Ford was reputed to have said that Americans could choose any color car they wanted—as long as it was black. Well, we must do better than provide one program—we need a whole array of ideas that a diversified economy can use.

We simply cannot afford to turn our backs on those disadvantaged Americans who have been left out of our economic life. I am convinced that the overwhelming majority of Americans agree with me when I say that we cannot, we must not, we will not give up the search for new ideas until all people in this country enjoy the opportunity to participate in our economic system.

The witnesses before us have had incredibly rich and varied experiences with manpower policies in both the public and private sector. We are looking forward to their presentation of an interesting menu of specific policy options to reduce structural unemployment.

Mr. John Palmer, a senior fellow at the Brookings Institution will be our leadoff witness.

Mr. Palmer.

## STATEMENT OF JOHN L. PALMER, SENIOR FELLOW, ECONOMIC STUDIES PROGRAM, THE BROOKINGS INSTITUTION

Mr. **Palmer.** Thank you, Mr. Chairman.

Let me start by offering a brief apology for the brevity of my prepared statement and not getting it up here in advance. Both are attributable to the conditions that I think everyone understands.

As you know, the achievement of the Humphrey-Hawkins Act joint targets of a 4-percent aggregate unemployment rate and a 3-percent annual rate of inflation by 1983—or, for that matter, at any time in the foreseeable future—place a considerable premium on the effectiveness of structural employment and training programs.

So, it seems to me particularly appropriate that we examine them carefully at this point in time to see what realistic assessment of their potential we have for both present and future uses and the extent to which we can expect them to contribute toward achievement of the goals of the Humphrey-Hawkins Act.

I wish I could tell you, if we had the will and were prepared to spend enough money through the use of such programs that we could reach those targets.

I am afraid I don't believe this is the case. The problems are too complex and intractable for me to be optimistic at this time.

Even the element of the employment and training programs is elusive in terms of knowing how much we can expect from it at this point in time, although our understanding of some of the theoretical requirements for structuring of such programs to have the desired impacts of increasing employment with minimal inflationary pressures has progressed quite a bit in the last few years.

There is still a lot we need to learn, however, particularly about the operation of the labor markets in which low-skilled workers are employed and, particularly, the design and operation of many of the programs oriented to meeting structural objectives.

Let me briefly respond to each of the questions you raised in the letter you sent inviting me and sketch out a few thoughts I have, and then I will be glad to respond to questions.

First, what are the requirements for countercyclical versus structural policies?

In theory, I think all training programs are intended to address structural problems of one kind or another, whether institutional programs, on-the-job training programs, or those of a different type.

There are quite different focal points or emphases that one might have as to the type of structural problems they meet, increasing supply of skilled workers for a particular operation or a declining industry to make a transition to a new vocation.

In general, structural objectives are in mind with all training programs, in contrast with direct job training programs, by which I mean work experience and public sector employment programs and the subsidization of private sector wage payments by employers.

These have been used in the past to promote both structural and countercyclical objectives. I think these objectives require different types of programs.

Job creation programs, if they are countercyclically oriented, should be temporary, should be utilized only when a general economic stimulus for the economy is desired and they should be applied to the margins of employers' labor forces.

In addition, they should be fairly broadly targeted on the unemployed rather than focusing narrowly on particular target groups.

Examples of programs I think are designed to serve these needs are the recently expired new jobs tax credit and public service employment under CETA title VI.

Programs that are designed to meet counterstructural or structural concerns ought to be much more permanent in their duration.

They ought to be quite narrowly targeted on workers who have the most serious labor market difficulties, and they ought to apply to all new hires of such workers if they are directly subsidizing employment in the private or public sector.

Programs to serve these objectives are public service employment under CETA title II and the new employment tax credit.

In both cases, I think there are some changes or different emphasis that might be given to these programs to make them improved vehicles for reaching structural objectives.

What ought to be the priority of structural employment and training programs over the last few years particularly in light of the economic outlook?

As I noted, there are many different structural problems. Attention needs to be paid to all of these, but I would urge we follow a balanced approach, placing equal emphasis on the demand and supply sides of the labor market.

We need to follow policies which affect the job skills for low-skilled workers and policies which facilitate the matching of workers and job opportunities.

Let me briefly highlight three particular objectives that I think deserve the most priority in the next few years.

First is the general problem that I think is what is in most people's minds when structural employment is raised, and that is trying to aid the low-skilled, high unemployment groups that suffer disproportionally from unemployment even when we have a relatively full employment economy.

In particular I would single out minority youth and adult women who are entering or reentering the labor force.

In trying to improve their opportunities, I would urge one thing be kept clearly in mind, and that is that it is important to distinguish between an increase in the employment rates or employment opportunities for such groups and the extent to which we can actually reduce their unemployment rates.

I think we can make considerable progress in increasing employment opportunities for such groups, but we will not see that translated into as sizable reductions in unemployment rates as we might like.

In part this is because the labor force participation rates of such groups are quite volatile, and in response to continued and large increases in job opportunities, many people from such groups newly enter the labor market.

So, the measured unemployment rate may not drop even though we are making considerable progress, and I think that is what happened in the last few years to some extent.

You mentioned in your introductory remarks the tremendous expansion of job opportunities in the past few years. This has not been accompanied by as great a reduction in the unemployment rates among some groups as one might hope, but there has been a large increase in employment in these groups.

In addition to seeking to increase employment rates, I think it is also important to focus on the extent to which the increased employment of such groups does add significantly to the production of goods and services that are desired by the public, and does lead to improved future employment opportunities in unsubsidized employment.

It is not enough to just create a job. We also want to make sure the job is productive in terms of what is being produced and in terms of where it leads in the future for such individuals.

So, evaluations and assessments of such programs need to focus on those two dimensions as well as whether a person is statistically being measured as employed or not.

A second structural goal is to try to reduce skilled labor bottlenecks. As the unemployment rate gets to low levels, there is a lack of skilled workers in occupations which puts upward pressure on wage rates and creates shortages.

In the early 1960's, under the Manpower Development Training Act, this kind of rationale for programs was in people's minds very much.

I think it has been pushed too much into the background recently, and deserves greater emphasis. It means increasing the supply of highly skilled workers—it is often difficult to take disadvantaged workers and move them immediately into such occupations. You have to take people who have lower level skills and upgrade them, therefore opening up opportunities for totally unskilled workers to move in behind them.

It means some of our programs need to be targeted on the disadvantaged in such a way as to open up these opportunities.

Third, I think regional economic development ought to be an increasingly high priority. By this I mean that we now have a lot of cities that are attempting to revive their economic base, attract industry, and employ other means of promoting economic growth.

We have other areas that are high growth areas, but where there are major problems in the composition of the labor force. I think there is a role for manpower programs to be more carefully coordinated with our economic development programs, particularly at the local level, in order to try to insure that the kinds of training that people are being provided will mesh very well with what needs are for the labor force, given the course of economic development that is taking place in any given local area.

Senator BENTSEN. We have a problem in Houston. We have an area that overall has a very low unemployment rate, but I can take you into the Fifth Ward and show you a very high unemployment rate.

It is an extremely difficult problem to figure out what to do about it. The ward is just blocks away from jobs.

Mr. PALMER. Yes. Now, it is a difficult problem, and I think the CETA system is slowly moving in the direction where it is going to have the capacity to do a better job in making that match, but we have to realize that it is fairly new and has only been in place a while.

The emphasis has been on the major expansion of public service employment and work experience programs, and not so much meshing that into the private sector.

I think this ought to be a major thrust in the future.

The third question that you raised is what mix of structural programs are the most appropriate over the next several years.

Before answering that directly I want to note that I think structural objectives as opposed to countercyclical objectives ought to dominate employment policy and training programs over the next several years unless it becomes quite evident that the economy is heading into another recession.

Only in that case would I shift my emphasis toward countercyclical objectives.

Even if that becomes necessary, I want to stress that I think it is extremely important that we don't allow the counter-cyclical concerns to divert us too much from mounting a consistent and sustained effort at structural problems.

We have had erratic policy over the past few years where we have initially concentrated on structural programs, and then we come in and shift directions considerably in terms of what the CETA system, at least, is asked to do.

While some of this is desirable to meet the immediate countercyclical concerns, it diverts attention from the structural programs.

Now, within this context of structural objectives, I think more emphasis in the future ought to be put upon programs that have a high degree of training content, and particularly programs which emphasize as immediately as possible private sector employment.

In your introductory remarks you mentioned some of the reasons for this. This is where the major area of job expansion is, in the private sector, and I think we ought to try to place people immediately in private jobs.

I think the greatest potential for overcoming inflationary bottlenecks is in the private sector.

I think we have not placed enough emphasis on skill training because of the countercyclical public employment in the past few years, and I think we need to move more in the direction of expanded on-the-job training programs and apprenticeship programs.

Even more fundamentally, I think strengthening the bonds between the CETA system and the private sector needs to be a priority.

There is a new initiative under the CETA system going into effect this year that tries to do that. I think that is an important step and one that needs to be closely monitored, and we need to see what additional strengthening of that activity will make sense in the near future.

There still is, I think, a very important role for public service employment.

Both the Congress and the administration have been in accord in terms of moving toward more narrow targeting and increased training emphasis within the structural public employment titles.

I think both of these thrusts ought to be strengthened and continued in the future. We ought to be sure that the programs are narrowly targeted on the 1 or 2 million people in the labor force who have the most difficult times finding job opportunities, and we ought to be increasing the training for them.

Senator BENTSEN. May I ask you to summarize, because there are a number of witnesses, and we will place your full prepared statement in the record.

Mr. PALMER. In conclusion, your last question was, How large an impact these programs could be expected to have?

I would sum up by saying that I think they are an important part of an overall employment policy and one that will hopefully improve the situation with minimal inflationary pressures.

I am not too optimistic that we can see them having a major effect on the unemployment rate in the near future, although I think they can have a major effect on the employment opportunities for the target groups concerned.

If you look down the road, I think continued expansion of these programs might be desirable. However, for the immediate future, I think there is a lot of ongoing knowledge generated in the youth areas and nonpublic employment areas that need to be monitored carefully before we have a really good sense of what the potential for major expansions of these programs are in a way that would be very effective in the future.

Thank you.

Chairman BENTSEN. Thank you very much.

[The prepared statement of Mr. Palmer follows:]

### PREPARED STATEMENT OF JOHN L. PALMER[1]

Mr. Chairman and committee members, thank you for inviting me to testify before you today on this most important subject. As you know, the achievement of the Humphrey-Hawkins Act joint targets of a 4 percent aggregate unemployment rate, and a 3 percent annual rate of inflation by 1983—or, for that matter, at any time in the foreseeable future—place a considerable premium on the effectiveness of structural employment and training programs. Thus, it is extremely important that we have a realistic assessment of their potential, both present and future, for contributing to these most worthwhile dual objectives, and that we understand the implications of alternative approaches to their design and operation.

I wish I could tell you that if we simply had the will, and were prepared to spend the money, that there is a way—paved with an appropriate set of structural employment and training programs—to expeditiously reach the Humphrey-Hawkins promised land. I do not believe this is the case. The problems in doing so are far too complex and intractable to allow for such optimism, and their successful solution depends upon a myriad of factors of which the establishment of a highly effective set of structural employment and training programs is just one of many elements.

Even this aspect of a more comprehensive "full-employment-with-minimal-inflation" policy remains somewhat elusive to us at this time. Our understanding of the desired theoretical requirements of structural employment and training programs has advanced considerably in the past few years. There is still much we need to learn, however, particularly about the nature of the operation of labor markets. And the design and operation of our programs need to be sharpened to more clearly reflect structural objectives, if they are to be given the top priority that they should.

#### COUNTERCYCLICAL VERSUS STRUCTURAL POLICIES

In theory, all training programs are intended to address structural problems; whether institutional, on-the-job, or of other varieties. Several different foci within this broader intent are possible, such as aiding disadvantaged, low-skill or handicapped workers, increasing the supply of skilled workers in occupations for which employers' demand exceeds the supply, or assisting workers in a failing industry to adjust to a new vocation. In contrast, direct job-creation programs—work experience, public service employment and the subsidization of private-sector employers' wage payments—can and have been used to promote both structural and countercyclical objectives.

The design requirements of job-creation programs are different, however, depending upon which objectives are of concern. Countercyclically-oriented programs ought to be temporary, utilized only when general economic stimulus is desired, and applied only to the margins of employers' labor forces. In addition, they should be fairly broadly targeted on the unemployed. Examples of programs reasonably well designed to serve countercyclical objectives are the recently expired New Jobs Tax Credit and public service employment (PSE) under CETA-Title VI. Structural programs, on the other hand, ought to be more permanent, narrowly targeted on workers with the most serious labor-market difficulties and apply to all new hires of such workers. Examples of job-creation programs intended to serve structural objectives are PSE under CETA-Title II and the new Targeted Employment Tax Credit. Their design still leaves considerable to be desired if they are to well serve structural objectives.

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[1] The views expressed herein are my own and should not be attributed to other staff, officers, or the trustees of The Brookings Institution.

## WHAT OUGHT TO BE THE PRIORITY OF STRUCTURAL EMPLOYMENT AND TRAINING PROGRAMS?

As I noted earlier there are many different types of structural problems that might be addressed by employment and training programs. Attention needs to be paid to all of these, with a balanced approach placing equal emphasis on both the supply and demand sides of the labor market. That is, we need to pursue simultaneously policies which improve the skills of workers, policies which affect the availability of job opportunities for low-skill workers, and policies which facilitate the matching of workers and job opportunities. Let me briefly mention three particular objectives which deserve particular emphasis.

*Aiding low-skill, high-unemployment groups.*—The structural unemployment problem, which is most often discussed, of course, is the relatively high unemployment rates among selective demographic groups of workers. The improvement of job opportunities for those groups experiencing the highest relative unemployment rates—particularly minority youth and adult women newly entering the labor force—ought to be a high priority. Although important, it would be a mistake, however, to focus too much attention on reducing the unemployment rates of such groups. Of greater significance are increases in their employment rates. Typically, their labor-force participation rates are quite volatile and will increase significantly along with increased job opportunities for them as groups. Thus, policies could be quite successful in increasing their employment, while having only a small or negligible effect on their unemployment rates.

In addition, while increased employment opportunities are an important end unto themselves, they are of the greatest benefit when they add significantly to the production of goods and services that are desired by the public and lead to improved future employment opportunities for target group members. These two factors should also receive prominence when policies to aid low-skill, high-unemployment workers are assessed. The granting of a job that has neither of these characteristics may be counter-productive.

*Reducing skill bottlenecks.*—One of the factors that contribute to inflationary pressures at lower rates of aggregate unemployment is growing shortages of skilled workers in particular occupations. Greater attention ought to be focused on identifying such occupations and utilizing training and upgrading programs to increase the supply of workers into them. Although of considerable concern in the early 1960's, this aspect of employment and training policy has been neglected more recently because of the considerable emphasis on both disadvantaged workers and countercyclical objectives.

*Aiding regional economic developments.*—This, again, was an emphasis of the early employment programs under the Manpower Development and Training Act and Area Redevelopment Act which has been neglected in recent years. A concentrated effort is now being made by many state and local governments, often with considerable federal assistance, both to promote economic growth in stagnating areas through tax incentives and a generally improved economic infrastructure, and to achieve more balanced growth in rapidly developing areas. Employment and training programs ought to be more closely coordinated with these efforts and tailored to facilitate the availability of the type of local labor force which is consistent with the desired directions of development. Success of these efforts would be measured by the extent of the "fit" of the outgoing clients of such programs with the skill and occupation needs of local employers.

## WHAT MIX OF STRUCTURAL PROGRAMS ARE THE MOST APPROPRIATE OVER THE NEXT SEVERAL YEARS?

First, let me note that structural objectives, as opposed to countercyclical ones, ought to dominate employment and training policy programming over the next several years, unless it becomes quite evident that the economy is heading into another recession. Even then it is important that we not allow countercyclical concerns to divert us unduly from the important task of mounting a consistent and sustained effort aimed at structural problems. This has happened all too often in the past.

Within this context, and in light of the priorities I identified just above, I believe a considerable emphasis ought to be put upon programs with a high degree of training content, particularly those which emphasize private-sector employment. More training is necessary in order to provide workers with the necessary skills to take advantage of what will hopefully remain a rapidly expanding job market. The private sector ought to be emphasized because that is where the overwhelmingly high proportion of new job opportunities will be located and because that is where the greatest potential lies to eliminate inflationary skill bottlenecks and to improve measured productivity. I would particularly favor an expansion of OJT programs in general and apprenticeship programs in particular. More generally, greater linkage between CETA programs and the private sector needs to be developed and there ought to be greater utilization of private employers as providers of training to desired target groups.

Two new activities ought to be closely monitored and assessed—the Administration's private-sector initiative and the new Targeted Employment Tax Credit. Modification or expansion of them might be in order once sufficient concrete experience has been gained.

Despite the desirability of a greater private-sector orientation, there is still an important role to be played by public service employment. Both Congress and the Administration seem to be in accord on the desirability of narrowing the targeting and increasing the training component of the structurally-oriented PSE under CETA. If anything, I think these thrusts ought to be extended further in the future. Public service employment ought to be increasingly targeted on those with considerable difficulty in finding and maintaining unsubsidized jobs and who might otherwise have to turn to public support for income maintenance. When the size of the pool of people eligible runs as high as 20-25 million, as it previously did under CETA, we can be sure we are not reaching the desired population. There are considerable difficulties in arriving at appropriate eligibility criteria, but greater attention must be paid to this issue, with the ultimate goal of focusing in on the one or two million most disadvantaged workers.

Youth programs are another matter. We are presently in the midst of one of the most ambitious learning activities of social welfare policy with the myriad of demonstrations mounted under the Youth Employment and Demonstration Projects Act of 1977. Information from these will be flowing in starting later this year and for the next two to three years. This experience should play a large role in guiding future policy. It is too soon yet to render any judgments on what future policy directions ought to be.

## HOW LARGE AN IMPACT CAN BE EXPECTED FROM STRUCTURAL EMPLOYMENT AND TRAINING PROGRAMS

In assessing the potential impact of structural employment and training programs, it is important to bear two important distinctions in mind—that between increasing employment and decreasing unemployment and that between increasing overall employment and achieving a more favorable distribution of employment opportunities with a given level of employment. The potential for structural employment and training programs to bring about a more favorable distribution of employment opportunities is substantial, to increase total employment (consistent with a given inflation target) less so, and to reduce the measured unemployment rate (again, consistent with a given inflation target) small. While I can only speculate, my guess is that the current set of programs is having a substantial positive effect on the employment levels of certain categories of workers with structural difficulties (particularly minority youth), a less substantial but still considerable effect on the unemployment rates of such workers, and a minor (at most a few tenths of one percent) effect on the aggregate unemployment rate.[3]

I do not think existing evidence provides much guidance on what might be expected from a major expansion of such programs, in part because of our present inability to quantify accurately the impacts of present programs, and in part because of uncertainties about unintended side effects (such as displacement of unsubsidized employment or training activities that otherwise would have occurred) and the capacity of existing institutions to absorb or manage effectively such an expansion. Regarding this latter, it is important to remember that the largely decentralized CETA system has been in place for only a few years and that in that brief period it has had to manage a rapid expansion in program types and expenditures as well as several shifts in policy emphasis from the federal level. Considering the circumstances it has performed admirably. For the next few years a more stable environment for CETA and an increased focus on structural concerns is desirable. After that (and with our rapidly growing capacity to assess the consequences of these programs) we will be better able to judge the future potential effectiveness of structural employment and training programs.

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[3] This assumes that fiscal policy would be equally stimulative in the absence of such programs.

Senator **Bentsen**. Ms. Sawhill, would you proceed, please.

## STATEMENT OF ISABEL V. SAWHILL, DIRECTOR, NATIONAL COMMISSION FOR EMPLOYMENT POLICY

Ms. **Sawhill**. Senator, I certainly appreciate the opportunity to appear here today and I want to note that the amendments to CETA which require the Joint Economic Committee to submit a report on these issues later this year, also ask the National Commission for Manpower Policy to assist the JEC, and we are pleased to do so, since we are very concerned with these issues.

I want to note that the full Commission has not had the opportunity to review the testimony that I prepared today, and might not concur with all of my views.

Nevertheless, we hope to be sending you our fourth annual report very soon, and you will note in the report that the Commission has addressed the issues being discussed here today. The Commission recommends that the highest priority be given to new studies and to a national debate on ways to maintain and increase employment without exacerbating inflation.

In my prepared statement, what I have tried to do is address three questions. These are the three questions which were highlighted in the CETA amendments, and which were also highlighted by Representative Parren Mitchell last week.

The first question is whether or not selective employment and training programs can reduce the relatively high unemployment rates among certain segments of the labor force; the second question is whether they can decrease the national unemployment rate without exacerbating inflation, and the third question is the extent to which new kinds of incentive grants or other mechanisms can be used to involve the private sector more in providing opportunities for the structurally unemployed. I will take each of those questions up in turn.

On the first one, whether or not these programs can achieve and sustain a decrease in unemployment rates among those segments of the labor force having special difficulty in obtaining employment, my answer could be summarized as follows:

First, until recently, these programs were relatively untargeted. Last year our staff estimated, for example, that under the old CETA legislation there were 27 million eligibles for about 2.4 million slots.

Obviously, this left a great deal of discretion in the hands of sponsors to define who was in need of special assistance; and although I believe some such discretion is desirable since any set of Federal eligibility criteria are bound to be somewhat arbitrary, nevertheless, I do believe the amount of discretion that they have had in the past is not consistent with achieving structural objectives.

There is still the problem of how you design, in terms of eligibility criteria, those groups having special difficulties obtaining employment.

I don't believe that family income and duration of unemployment completely capture what we mean by that phrase, although they are the best that we have been able to come up with so far.

Second, I want to make the same point that Mr. Palmer did, which is that these programs are more likely to change the distribution of employment than the distribution of unemployment because they tend to attract people from outside of the labor force.

My own feeling is that the line between being counted as officially unemployed and being out of the labor force has become very, very thin, indeed, and that it would be better if we paid less attention to measured unemployment per se.

The third point is that special job creation programs can normally be expected to improve employment opportunities for the groups they are targeted upon, but we should be careful not to assume that this will occur on a one-for-one basis, the reason being that many of the people who participate in these subsidized job programs would otherwise have found employment in the regular labor market.

The extent to which there is this substitution of subsidized employment for unsubsidized employment depends, of course, largely on the wages and working conditions being offered in the subsidized jobs relative to those in the regular labor market.

Fourth, assuming that these programs are successful in improving employment opportunities for the target groups, you have to then ask, "Well, is that at the expense of other members of the labor force"?

I don't think we can pretend that there isn't some loss for these other groups. However, I don't think the loss is one for one.

I think that, particularly if labor markets are highly segmented by age, race, or sex that when you improve the opportunities for one group it doesn't necessarily lead to declines in opportunities for others. If, in addition, you combine selective policies with more general stimulus measures, you have some potential to reduce overall unemployment rates rather than just substituting the unemployment of one group for the unemployment of another.

I would like now to turn to the second question, and that is the question of whether targeted programs can achieve and sustain a decrease in the national unemployment rate without exacerbating inflation.

I have touched on this issue tangentially but I want to address it a little more specifically.

I am not sure I have anything terribly new to say here. I would again agree with Mr. Palmer that we don't know enough about this question, and we don't have enough confidence in structural programs as yet to say that they can carry us very far toward achieving Humphrey-Hawkins type objectives.

However, the theory is that if we can target on loose labor markets and expand demand there, and then at the same time expand the supply of skilled workers to tight labor markets, where skill bottlenecks push up wages, that something could be accomplished on this front.

One more issue which we have already discussed and which you raised in your comments about Houston is that the theory is very difficult to translate into practice. We just simply have not come up with very good ways of identifying and then targeting on either loose or tight labor markets.

The second point I want to make in response to this question is that employment and training programs can reduce unit labor costs.

They can do this either by improving productivity at existing wages, or by directly reducing wage costs through subsidized job programs.

A reduction in unit labor costs, in turn, will in many cases be passed on to consumers in the form of lower prices. In the case of public employment programs, any reduction in labor costs is going to get passed on to citizens in many cases in the form of lower sales or property taxes, but the results are somewhat similar.

I think that rather than taking up any more time on the question of inflation, I would now like to turn to the third question that I raised at the outset, and that is the role of the private sector in helping to achieve these structural objectives. Specifically I want to focus on a comparison between job creation in the public sector and job creation in the private sector.

I have quite a lengthy prepared statement about all of this, which I hope you will have an opportunity to read at your leisure, and I will only be able to give you the highlights now.

There is a table, if you have a copy of it up there, which might be useful to glance at while I am talking. It is table 2 of my prepared statement.

What the table does is categorize job creation programs according to whether they take place in the public sector or the private sector, and then further categorizes them depending on whether they have countercyclical or counterstructural objectives. Finally, examples of existing programs that fall under each of these categories are listed and I have tried to give the best estimates that I can come up with of some of the relevant data in the body of the table.

Without going through those numbers—taking it on faith that I have analyzed them correctly—I think that the possible conclusions and policy recommendations one could come up with would be more or less the following:

First of all, we are currently spending far more of our budgetary resources on public sector than on private sector job creation.

I would say that the ratio is roughly on the order of 3 to 1, even after allowing for the fact that some of the tax credit programs have not yet built up to their full strength, and our estimates of how much they will be utilized is very uncertain at the current time.

Senator **Bentsen**. Ms. Sawhill, let me say that the administration strongly opposed the initial tax credit by the private sector and as a result, it was one of the best kept secrets of that year.

A lot of employers didn't have any knowledge of it at all. Let's hope that will change.

Ms. **Sawhill**. I think that can make a great deal of difference. Indeed, one of my recommendations is that we must market these programs much better than we have in the past.

My second point here, though, was that we might think about moving toward more common eligibility standards across all of these programs.

I would submit that we do not currently have a countercyclical program in place, although we have something called countercyclical PSE. But, if you look at the eligibility rules under CETA title VI, it is really oriented toward the structurally unemployed. It may not be as tightly targeted as title II, but it is certainly not countercyclical, except to the extent that the scale is varied with the state of the economy.

Finally, having done away with the "New Jobs Tax Credit," the new tax programs are structurally oriented as well.

So, we have all these various devices in place for providing job opportunities for the structurally unemployed, and you have to ask why it is that we have different programs for different groups.

I don't think the answer has been rationally thought through. I don't know, for example, why we should have a welfare tax credit for public assistance recipients on the one hand and a targeted jobs tax credit for seven other disadvantaged groups on the other. And I don't know why these groups, in turn, should be different from the groups eligible for CETA title II.

There could be good reasons for making distinctions between the programs, but no one has come up, in my mind, with a satisfactory rationale for why you want to segment programs in the particular way that we have segmented them.

Next, in my comparison of public and private approaches, I look at the level of subsidization in each of these programs. I note that PSE programs are effectively 100-percent wage subsidies for public employers.

I then have to raise the question: Why do we provide 100-percent subsidies to public employers and far less than 100-percent subsidies to private employers, particularly when I think we would probably agree that the target groups in the private sector programs are more difficult to employ? If anything, there would be a rationale for providing deeper subsidization where you have your most difficult-to-employ groups, and it seems to me right now we have that backward.

A lot of debate about PSE versus wage subsidy or tax credit programs involves an estimation of the net budget costs of each of those approaches. These costs, in turn, depend on what people tend to believe about substitution or windfall gain, or whatever you want to call it, when we pay employers to do what they would have done anyway.

I have gone through the evidence on this issue in my testimony, and to give you the bottom line again, I conclude that there is no evidence that the net budget cost of producing jobs is inherently lower in the public sector than in the private sector. If anything, I think the evidence suggests that job creation may be less expensive in the private sector.

Senator BENTSEN. You don't know what happens to them after a subsidized period?

Ms. SAWHILL. We don't have much direct evidence on that question. One can speculate that the transition into unsubsidized jobs is probably higher, if you can place people in the private sector. For one thing, they may stay with the employer that provided them with a subsidized job, but even if they don't, they may have greater opportunities to make a successful transition. All of the anecdotal evidence that I have picked up around the country—and there are a few surveys that bear on this question—indicate that private employers heavily discount experience in the public sector, especially subsidized experience in the public sector.

Senator BENTSEN. Ms. Sawhill, I will have to ask you to summarize. This is really quite interesting, and I am going to use a lot of the material you submit in debate on the floor.

Ms. SAWHILL. I would be happy to have that happen, and to continue to help you in any way that I can.

I do make a point in my prepared statement about the importance of informing employers about the availability of tax credit programs, and making sure the regulations are not so burdensome that they won't use them.

Senator BENTSEN. What did you say?

Ms. SAWHILL. I have a recommendation here about the point that you raised earlier, which is the importance of marketing the tax credit programs and informing employers about their existence.

Also, it is important to reduce the burden of administrative redtape. I have read the guidelines that the Department of Labor has sent out to the prime sponsors across the country in which they have been told that as part of the implementation of the new title VII, they should market these tax credit programs, and I think there is a real effort to overcome some of these past problems, but it will take continuing work.

Well, I think that in view of the time, I will stop here and perhaps have an opportunity to comment further if I think there are some gaps later on.

Senator BENTSEN. Thank you.

Ms. Sawhill, without objection, we will insert the entire prepared statement of each of our witnesses today in the hearing record.

Ms. SAWHILL. Thank you, Senator.

[The prepared statement of Ms. Sawhill follows:]

### PREPARED STATEMENT OF ISABEL V. SAWHILL

Mr. Chairman and members of the committee: I very much appreciate the opportunity to participate in this important set of hearings on structural unemployment. I understand that testimony from these hearings will be used in preparing the Joint Economic Committee's report to Congress this spring.

The National Commission for Employment Policy, which is required by the 1978 amendments to the Comprehensive Employment and Training Act to assist the Joint Economic Committee in this endeavor, is pleased to do so. I want to note that the full Commission has not had an opportunity to review the testimony I will be giving today, and thus might not concur with my views. Nevertheless, the Commission is deeply concerned about these issues. In its *Fourth Annual Report to the Congress and the President*, which will be issued next week, the Commission recommends that:

"The highest priority be given to new studies and a national debate on ways to maintain and increase employment without exacerbating inflation."

and further states that:

"There must be better ways for a civilized society to deal with inflation than to pursue policies that increase unemployment."

It is my understanding that the overall purpose of these hearings is to examine the ability of selective employment and training programs (1) to reduce the relatively high unemployment rates among certain segments of the labor force, and (2) to decrease the national unemployment rate without exacerbating inflation. I believe that ascertaining the answers to these questions, and acting upon them, should be high on the nation's agenda. Yet there are very few people, either in or out of government, who are focusing on these questions. As a result, we know far less than we should about the answers.

The current administration came into office committed to the principle of using selective employment measures to reduce unemployment. The economic stimulus package of 1977 was heavily weighted in this direction, especially in its unprecedented reliance on public service employment. However, because these programs were somewhat new and untried, because they were designed to meet many conflicting objectives, and because of their administrative complexity which has made them difficult to manage, these programs have subsequently fallen out of favor among many members of the public and their representatives in Congress.

Simultaneously, there has been some questioning within the academic community of whether such programs—even if perfectly designed and implemented—can achieve the two objectives which are the focus of these hearings. In this context, I have read with interest the testimony of those witnesses who appeared before this Committee on February 6. Although the final verdict is not in and probably won't be for many years to come, my reading of this literature suggests that the jury, although not unanimous, is generally optimistic about the ability of carefully designed employment and training programs to reduce unemployment in relatively noninflationary ways. However, those who are skeptical about this potential are asking valuable questions; and they are probably right to suggest that we should lower our expectations.

What all of the foregoing suggests to me is that we need to move forward aggressively on two fronts. First, we should continue to support basic research on what the economic effects of selective employment and training policies would be if they were designed and implemented according to the best specifications that our theoretical understanding can provide. Second, we should seek to improve the design and implementation of current programs to move them closer to these theoretical specifications. Quite specifically, we should seek to improve on the record of recent years by distilling from that experience the modifications in design and administrative practice which can make a difference in achieving critical objectives in the future. Clearly, the Administration and the Congress have already begun this process. They have refocused CETA on the structurally unemployed, tightened up on the administration of the program, put a new Targeted Jobs Tax Credit in place, and revised the WIN and Welfare Tax Credits in response to past criticism. Continued monitoring, evaluation, and revision will be essential if we are ever to have enough confidence in these programs to use them on the much expanded scale that would be needed to achieve the objectives of the Full Employment and Balanced Growth Act of 1978. The national commitment to full employment and price stability is in place, but we cannot meet the goals of this Act by waving a magic wand. The only recourse is to begin now to experiment with new and revised approaches in the hope that they can become the vehicle for translating our aspirations into reality.

## THE ABILITY OF EMPLOYMENT AND TRAINING PROGRAMS TO CHANGE THE STRUCTURE OF UNEMPLOYMENT AND REDUCE THE NATIONAL UNEMPLOYMENT RATE IN NONINFLATIONARY WAYS

I would like now to summarize for you my own thoughts on the two key issues which the Congress has requested the JEC to report on in March.

First, "can targeted structural employment and training programs achieve and sustain a decrease in unemployment rates among those segments of the labor force having special difficulties in obtaining employment?"

(1) Until recently employment and training programs were relatively untargeted. The staff of the Commission has estimated that, under the old CETA legislation, there were 27 million eligibles for about 2.4 million slots. This left a great deal of discretion in the hands of local prime sponsors to decide who was "having special difficulties in obtaining employment." Some discretion is desirable since any set of federal eligibility criteria is bound to be somewhat arbitrary. However, without the tighter targeting introduced in more recent legislation, the programs could not effectively serve structural objectives. The issue of how to define "structurally unemployed" or those having "special difficulties obtaining employment" remains. Family income and duration of unemployment are imperfect criteria.

(2) Targeted employment programs are more likely to change the distribution of employment than the distribution of unemployment since any expansion of opportunities will attract people from outside the labor force. Many of the latter are discouraged workers who face special difficulties in obtaining employment, so this need not be viewed as a negative outcome.

(3) Special job creation programs can normally be expected to improve employment opportunities for target groups, but it should not be assumed that they will do so on a one-for-one basis. Many of the people who participate in these programs would otherwise have found employment in the regular labor market. This displacement of regular employment by subsidized employment is particularly likely to occur if wages and working conditions in subsidized jobs are competitive with, or superior to, those being offered in the regular labor market.

(4) Assuming that the programs are successful in increasing employment and reducing unemployment among certain segments of the labor force, it is likely that these gains will be a least partially at the expense of other groups. This necessitates that some extremely tough political judgments be made about who should receive assistance. This kind of displacement of one group of workers for another will be less of a problem if labor markets are highly segmented (by age, race, sex, etc.) and if selective policies are used in tandem with general stimulus measures to reduce overall unemployment.

(5) We should distinguish between short-run or temporary changes in the structure of employment on the one hand and long-run or permanent changes on the other. PSE or work experience programs may be the quickest and surest way to change the structure of employment in the short run, but training and placement in the private sector may have the greater impact in the long run.

The second key question to be addressed at these hearings is:

"Can targeted structural employment and training programs achieve and sustain a decrease in the national unemployment rate without exacerbating inflation?"

(1) In principle, employment and training programs can reduce inflationary pressures by selectively expanding employment in loose labor markets where wages are unlikely to be responsive to increased demand. Alternatively, they can provide an increased supply of trained workers to tight labor markets in order to ease skill bottlenecks that push up wages. These principles have never been implemented on a scale which would provide a fair test of their efficacy. Moreover, identifying, and then targeting on, "loose" and "tight" labor markets is much more difficult in practice than in theory.

(2) Employment and training programs can also reduce unit labor costs either by improving labor productivity through investments in education and training or by subsidizing wages. A reduction in unit labor costs will, in many cases, be passed on to consumers in the form of lower prices, or (in the case of public employment programs) to citizens in the from of lower sales or property taxes.

(3) The above considerations suggest that in order to reduce the unemployment rate in a noninflationary way, employment and training programs should be designed to:

(*a*) improve the productivity of the labor force generally;

(*b*) provide trained workers in skill-shortage areas;

(*c*) provide subsidized job and training opportunities wherever there is a surplus of individuals who want to work at existing wages but for whom there would be no "effective demand" in the absence of such assistance.

(4) In part because they have been designed to achieve other objectives current programs depart from the above principles in several respects:

(*a*) They are heavily oriented toward providing income maintenance to low-income families rather than toward improving the overall productivity and efficiency of the work force.

(*b*) There is much more emphasis on job creation than on training; and what training occurs is relatively inexpensive, short-term, and thus not highly effective in improving productivity. Moreover, the skills which are imparted are not necessarily those that are in greatest demand.

(*c*) Job creation programs are not focused on the low-wage competitive sectors of the economy (most job creation is in the public sector). Moreover, they are not adequately targeted on areas of high unemployment. Finally, they do not always serve individuals who have no alternative employment opportunities and are, as a result, willing to accept low-level, low-paying jobs—although the recent amendments to the CETA legislation have moved the programs in this general direction.

It should be noted that there may be good reasons for not designing programs in accordance with the above principles. Specifically, if employment and training programs are viewed primarily as a way to improve the immediate distribution of income and job opportunities, then little emphasis need be placed on their potential to improve productivity and meet the needs of employers for skilled workers. In short, there may be some conflict between achieving equity and efficiency objectives which can only be resolved in the political arena. Programs designed to achieve a fairer distribution of opportunities will not necessarily be the best programs for raising the GNP and reducing the rate of inflation consistent with any level of overall employment.

## PUBLIC VERSUS PRIVATE SECTOR JOB CREATION

In the amendments to CETA requiring the JEC to report to the Congress on the efficacy of employment and training programs, there is a further request that the Committee examine "incentive grants" or other means of encouraging private employers to hire individuals eligible for CETA. In preparation for submitting its Fourth Annual Report, the Commission examined the role of the private sector in providing opportunities for the structurally unemployed in some detail. Accordingly, in the remainder of my testimony I will review our staff's and consultants' findings on the relative effectiveness of subsidized job creation in the public vs. the private sector.

The United States, unlike many European countries, has relied heavily on job creation in the public sector. But if selective employment programs are ever to be used on a much expanded scale, greater emphasis will probably need to be placed on creating jobs in the private sector.

Any analysis of these issues should begin by noting that:

(*a*) Wage subsidies and employment tax credits involve using the financial leverage of government to increase or redistribute employment opportunities in the private sector. Subsidies and credits are functionally equivalent and thus are often generically referred to as "employment subsidies." The choice between them rests essentially on administrative and political considerations. For example, subsidies appear in the budget while tax credits do not, and the legislation establishing each is handled by different congressional committees. One potential problem with tax credits is that they cannot be used to induce changes in the behavior of public or nonprofit employers unless they are made refundable.

(*b*) Current PSE programs are essentially 100 percent wage subsidies for the public sector. Thus, one can immediately distinguish between subsidized job creation in the private sector and subsidized job creation in the public sector.

(*c*) Such subsidies can be further distinguished by whether they are designed to achieve countercyclical or counterstructural objectives.

This particular characterization of programs leads to the four-way classification scheme indicated in Table 1. This classification, in turn, raises a number of further questions:

(*a*) What is the current allocation of the federal budget between these four program types?

(*b*) How do subsidy levels per job vary across programs?

(*c*) How do eligibility standards vary across programs?

(*d*) How many people are eligible for each program and how likely is it that the program can meet its defined universe of need?

Some of the data needed to answer these questions are provided in table 2. The major conclusions to be drawn from these data are:

(*a*) During FY 1979, spending authority for public sector programs is about $6 billion and estimated revenue losses from private sector programs are less than $200 million.[1] However, FY 1979 is, to some extent, a transition year in which the New Jobs Tax Credit is being phased out and the Targeted Jobs Tax Credit is being phased in. By FY 1981 the tax credit programs are estimated to produce revenue losses of about $800 million (see Table 2, footnote E).

(*b*) The subsidy level for the private sector programs is much lower than for the public sector programs although the private sector target groups are somewhat more disadvantaged.

TABLE 1.—TYPES OF JOB CREATION

| By location | By objective | |
|---|---|---|
| | Countercyclical | Counterstructural |
| Public Sector | Countecyclical PSE<br>Example: CETA title VI (1978) | Counterstructural PSE.<br>Example: CETA title II (1978). |
| Private sector | General employment subsidies<br>Example: New jobs tax credit (1977) | Categorical employment subsidies.<br>Example: Targeted jobs tax credit (1978). |

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[1] This does not include accrued revenue losses under the NJTC which will have their budgetary impact in fiscal year 1979.

## TABLE 2.—FUNDING AND ELIGIBILITY FOR COUNTERCYCLICAL AND COUNTERSTRUCTURAL EMPLOYMENT PROGRAMS

| | Public sector | | Private sector | | |
|---|---|---|---|---|---|
| | Countercyclical, CETA title VI | Counterstructural, CETA title II D | Countercyclical, new jobs tax credit | Targeted jobs tax credit | Counterstructural, WIN credit |
| Estimated funding level fiscal year 1979 budget authority estimated revenue loss. | $3,500,000,000 [1] | $2,500,000,000 [2] | $2,300,000,000 [3] | $100,000,000 [4] | $40,000,000.[4] |
| Subsidy level: [5] | | | | | |
| Average value after adjustment for business taxes (1st year). | 7,200 | 7,200 | 1,260 | 1,650 | 1,650. |
| Percent reduction in labor costs for a minimum wage job (1st year). | 100 percent | 100 percent | 50 percent | 50 percent | 50 percent. |
| Subsidy duration (maximum) | 18 mo | 18 mo | 12 mo | 24 mo | 24 mo. |
| Eligibility | Must be unemployed 10 out of past 12 weeks; and either low family income (100 percent BLS LLS) or AFDC/SSI family member. | Must be either unemployed for past 15 weeks and low family income (70 percent BLS LLS plus other "economically disadvantaged"); or AFDC/SSI family. | All employment in for-profit firms over a base level and subject to a cap. | Disadvantaged youth, 18 to 24, and 6 other groups (see table 1). | WIN participants those receiving AFDC for 90 days or more. |
| Estimated universe of eligibles [6] | 1,000,000 | 9,000 000 | Not applicable | 6,700,000 | 3,500,000. |
| Estimated participation level (person-years of employment).[7] | 400,000 | 275,000 | 1,100,000 | 209,000 | 57,000. |
| Estimated net job creation (direct effects only).[8] | 325,000 | 220,000 | 275,000 | 16,000 | 4,000. |

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[1] Based on 6 percent unemployment rate.

[2] 10 percent must be used for training.

[3] Gross revenue cost based on 1977 tax returns filed through December 1978. After deductions (estimated at 0.60) the net cost is $1,400,000,000 (Dildine, Treasury).

[4] Figures from Joint Committee on Taxation (Lepley). These are fiscal year 1979 figures which increase to 600,000,000 (TJTC) and 200,000,000 (WIN) by fiscal year 1981.

[5] In a tax credit program with a provision that subsidized wages may not also be deducted for tax purposes, the net value of the subsidy is (s-st) W where s is the subsidy rate and t is the employer's tax rate. For s=0.5 and t=0.4 (the average for all employers) and W=$5,500 (minimum wage), the value is $1,650 which is 50 percent lower than a presubsidy but post tax minimum wage of $3,300

[6] CBO estimates (Betsey) for CETA; tax credit rough estimates from DOL (Lerman).

[7] DOL estimates for CETA; Treasury estimate for NJTC; preliminary calendar year 1979 CBO estimates for TJTC and WIN.

[8] Based on 20 percent displacement in CETA; 75 percent displacement in NJTC; TJTC and WIN estimates are preliminary CBO numbers (Russek) based on 50 percent displacement for calendar year 1979.

Note: Almost all of the above estimates are based on incomplete information and a variety of reasonable but debatable assumptions; therefore, they should be used to suggest orders of magnitude only.

(*c*) There is overlapping eligibility across the various programs with no particular rationale in most cases. For example, the WIN and Targeted Jobs Tax Credits offer the same subsidy levels but to slightly different groups of people.

(*d*) The estimated universe of eligibles is only partially served in each program. In the case of public sector programs this is because of budget constraints. In the case of private sector programs, which are open-ended in a budgetary sense, it is due to a low take-up rate on the part of employers.

### PREVIOUS EXPERIENCE WITH PRIVATE SECTOR JOB CREATION PROGRAMS

The first full-fledged use of employment subsidies[2] in the United States was introduced as part of the Revenue Act of 1971 and was designed to encourage business firms to hire welfare recipients enrolled in the WIN program. This Act was later amended to cover a broader group of welfare recipients and to allow nonbusiness employers to participate. It has recently been amended again as part of the Revenue Act of 1978.

Under the pre-1978 law, employers were able to receive a tax credit equal to 20 percent of the wages paid[3] during the first 12 months of employment to individuals who had received AFDC for at least 90 days or who had been placed in employment under the WIN program.

The experience with the WIN and welfare tax credits has been disappointing. The Department of Labor has estimated that certifications for welfare credits have run less than 2,000 per year. In 1977 employers claimed WIN credits on behalf of only 30,000 workers. This number is less than 1 percent of all heads of AFDC families and only 5–6 percent of employed AFDC recipients.[4] In addition, two surveys have indicated that less than 10 percent of employers attributed their hiring of WIN enrollees to the availability of these credits.[5] It appears that employers have been confused by the differing rules under which credits may be claimed, discouraged by the paperwork involved, and that, in any case, the subsidy rate may have been too low to generate interest on the part of the employer.

The New Jobs Tax Credit (NJTC) was a more broadly based countercyclically oriented program to increase employment at lower wage levels. Passed as part of the Tax Reduction and Simplification Act of 1977, the NJTC provided firms with credits equal to 50 percent of the increase in their FUTA wage base over 102 percent of the previous year's base, subject to various limitations—such as a "cap" of $100,000 in credits for any one firm. The FUTA base for 1977 consisted of wages paid of up to $4,200 per employee. Thus, a firm which expanded its employment could receive 50 percent of a new worker's first $4,200 of earnings as a tax credit.

Evaluations of the NJTC have indicated (1) that many firms have been ignorant of its existence, (2) that many of those who knew about it did not qualify (for example, because their employment levels failed to expand sufficiently), and (3) that about one-quarter of those who knew about the credit and had established that they were eligible to receive it reported a conscious effort to increase employment as a result of the credit.[6] Three separate studies confirm that the program has had a positive impact on employment levels and at least one shows a significant reduction in prices as a result of the credit as well. Based on his review of various studies to date, John Palmer suggests that the NJTC may have produced several hundred thousand additional jobs during 1977–78 and a rate of inflation which was somewhat less than half a point lower for 1978.[7]

There are several lessons to be learned from these previous experiences:

(*a*) First, it is important to publicize information about employment tax credits and to market them more aggressively.

(*b*) Second, small subsidies or credits and capped programs may not be sufficient to encourage employers to change their behavior, especially in tightly targeted programs where the actual or perceived productivity of participants is likely to be low.

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[2] The NAB-JOBS program was, to some extent, a precursor of current employment subsidy programs, but since the emphasis was on OJT contracts, it is reviewed in NCMP 3-27-78, "On-the-Job Training: A Review of the Experience."

[3] Although this law has now been amended and the subsidy is more generous, the change is less than first meets the eye. Under the old law, employers could take a tax deduction against subsidized wages and under the new law they cannot. At a tax rate of 60 percent, the value of the two subsidies is equivalent. At any lower tax rate, the new law is somewhat more generous.

[4] Statement of Arnold H. Packer before the Subcommittee on Administration of the Internal Revenue Code, Committee on Finance and the Select Committee on Small Business, U.S. Senate, July 18, 1978.

[5] Daniel S. Hamermesh, "Subsidies for Jobs in the Private Sector" in *Creating Jobs*, John L. Palmer, ed., Brookings, 1978.

[6] Robert Eisner, "Employment Taxes and Subsidies" (processed), p. 19 ff.

[7] John Palmer, Statement before the Subcommittee on Administration of the Internal Revenue Code, Committee on Finance and the Select Committee on Small Business, U.S. Senate, July 18, 1978.

(*c*) Third, employers will not participate if they are required to comply with excessive amounts of regulation and paperwork. The administrative costs associated with recruiting and certifying eligible participants in targeted programs can be especially burdensome.

### THE COST OF PROVIDING JOBS IN THE PRIVATE VERUS THE PUBLIC SECTOR

Both public and private job creation programs suffer from the problem of displacement. That is, employers use the subsidies to hire people that they would have hired anyway. In PSE programs, this problem is often referred to as "fiscal substitution." In private sector wage subsidy programs it is often labelled, even more perjoratively, as a "windfall gain" for employers. These differences in terminology should not obscure the fact that the processes are essentially equivalent in the two cases.[8]

In the public sector case, the payroll savings generated by fiscal substitution improve the condition of local governmental budgets in the short run and frequently enable a local government to keep sales or property taxes lower than they otherwise would be over the longer run. In the private sector case, "windfall profits" in the short run may result in an expansion of output and lower prices (expecially in competitive industries) over the longer run. In both cases, there may be some reduction in inflationary pressures as a result of lower taxes or prices.

More generally, most of the funds initially freed up as a result of displacement are eventually channeled back into the economy. If this does not occur through such means as lower taxes or prices, then it will occur through greater dividend payments or investment in the private sector and less borrowing or more capital expenditures in the public sector. The distributional consequences of these secondary allocations of public funds are currently not known. However, there is clearly greater political revulsion against providing subsidies to the private as compared to the public sector. Federal government revenue sharing for private enterprise is not an idea whose time has come, except perhaps when such subsidies take the form of investment tax credits.[9]

These political considerations aside, the choice between public and private sector subsidy programs should rest, in large part, on the budget costs per job created. This cost, in turn, depends on:

(*a*) the level of the subsidy in each sector; and

(*b*) the displacement rate in each sector.

Currently, with much higher subsidy levels in the public than in the private sector (see Table 2), PSE is clearly a more expensive program unless it can be shown that displacement rates are very much lower in the public sector. Table 3 provides some figures to illustrate this point.

The table indicates that with a 20 percent displacement rate in the public sector and an 80 percent rate in the private sector, private sector job creation is still the cheaper alternative because the average subsidy level prevailing in CETA is much higher than the subsidy level established for the New Jobs Tax Credit.[10]

A critical question, then, is what are the displacement rates in these programs? Do they, in fact, diverge as much as suggested in the above example, and if so, why?

TABLE 3.—ESTIMATED COSTS OF PUBLIC VS. PRIVATE JOB CREATION

| | Public sector | Private sector |
|---|---|---|
| (1) Budget | $1,000,000,000 | $1,000,000,000 |
| (2) Subsidy level | [1] $7,200 | [2] $1,260 |
| (3) Total number of jobs subsidized (1) divided by (2) | 139,000 | 794,000 |
| (4) Displacement assumed | [3] 28,000 | [4] 635,000 |
| (5) Net job creation [5] | 111,000 | 158,000 |
| (6) Cost per job [6] (1) divided by (5) | 9,009 | 6,329 |

[1] Average wage level for CETA-PSE established by the 1978 amendments. Does not include overhead or training costs.

[2] Average subsidy level in the new jobs tax credit on 1st-year eligible wages (50 percent of FUTA base of $4,200 minus a 40-percent loss of tax offsets against subsidized wages).

[3] 20 percent.

[4] 80 percent.

[5] Net job creation on the 1st round of spending only. Additional jobs are created as the initial injection of funds flow through the economy.

[6] These estimates ignore the possible savings from welfare or other transfer programs and the increased revenues generated by extra employment.

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[8] It is assumed for the purposes of this discussion that both types of programs are financed in the same way and that any second-round economic effects which occur as the funds are channeled through the economy are similar.

[9] Revenue losses from the ITC are about $15 billion annually. An employment tax credit funded at this level would probably create in the neighborhood of 2.7 million new jobs (see Table 3).

[10] Both alternatives compare favorably to the costs of creating jobs via across-the-board tax cuts or increases in government expenditures which carry price tags in the neighborhood of $20,000 to $30,000 per job.

The 20 percent displacement figure used for PSE in the above example is consistent with the first round of evidence from the Brookings Institution monitoring study reported earlier by the Commission.[11] This is probably a lower limit since other studies have found higher displacement rates.[12] In any case, there is currently no consensus on what the "true" rate might be and how it varies over time and in response to variations in program design. A similar degree of uncertainty exists with respect to displacement in private sector programs. Several European countries which have used these schemes extensively report displacement rates of well over 50 percent but less than 75 percent.[13] Some early evidence from a survey of employers in the U.S. suggests that, of those who knew about the New Jobs Tax Credit and were eligible to receive it, about 75 percent used it to subsidize employment increases which would have taken place even without the program.[14]

The finding in Table 3 that the costs of job creation in the two sectors are roughly comparable is probably not coincidental and may have a more fundamental explanation. There is evidence that both public and private employers respond in much the same way to a decrease in the cost of labor by expanding employment.[15] It may simply be that the much larger subsidy levels per job in the public sector elicit correspondingly larger additions to employment. Viewed in this way it would not be at all surprising to find that the cost per job created is very similar across sectors.[16] Thus, the justification for higher subsidy levels in the public sector probably needs to be made on grounds other than cost. Possible arguments for providing deeper subsidies [17] to the public sector could include:

(a) A preference for public sector over private sector output;

(b) Targeting of public sector jobs on harder to employ groups and of private sector jobs on less disadvantaged groups; or use of public sector jobs to guarantee work to selected segments of the population which would necessitate full subsidization.

(c) More ability to control displacement in the public than in the private sector.

Deeper subsidies for the public sector provide cheaper labor to the public than to the private sector and could encourage an overexpansion of public relative to private sector output.[18] Of course, if this bias toward public sector output is deemed desirable, then more generous subsidies for this sector are also appropriate.

Another factor which might justify differential subsidization is different eligibility standards in the private and public sectors with public jobs being reserved for the least employable groups. However, a comparison of current eligibility rules for PSE (Title II) and for the WIN and Targeted Jobs Tax Credits suggest that the private sector programs are actually targeted on groups with more severe employment handicaps. Thus, there is currently no consistency between subsidy levels and eligibility standards. Nor is there any apparent rationale for using different eligibility criteria in the public vs. the private sector, and it may be desirable in the future to move these programs toward a common standard of need. Moreover, some standardization of eligibility criteria would permit greater centralization of certification procedures in a single agency which might then take on the responsibility for verifying and monitoring the income levels and other characteristics of participants. Without some attempt to streamline and improve these procedures, the potential for abuse and inequitable treatment of applicants is considerable.

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[11] National Commission for Manpower Policy, An Interim Report to the Congress: "Job Creation Through Public Service Employment," Report No. 6, March 1978, Volume II.

[12] See the review of the evidence in the paper by Michael Borus and Daniel Hamermesh in "Job Creation Through Public Service Employment", *op. cit.*, Volume III. Also Laurie Bassi and Alan Fechter, "The Implications for Fiscal Substitution and Occupational Displacement Under an Expanded CETA (Title VI," Urban Institute Final Report 1161, October 1978.

[13] See Appendix B-1, National Commission for Manpower Policy, *Fourth Annual Report.*

[14] Eisner, *op. cit.*

[15] That is, the elasticity of demand for labor is similar in the two sectors. See Daniel Hamermesh, "Econometric Studies of Labor Demand and their Application to Policy Analysis," *Journal of Human Resources*, Fall 1976, vol. II, no. 4, pp. 507–25. We don't know, however, the extent to which the elasticity varies with the level of the subsidy. Employer responsiveness may be relatively lower at higher than at moderate levels of subsidy which would tend to make public sector programs more expensive.

[16] This conclusion is shared by a number of experts. In fact, several have estimated that the costs are lower in the private sector. (Fethke, Policano, and Williamson, *An Investigation of the Conceptual and Qualitative Impact of Employment Tax Credits*, W. E. Upjohn Institute, August 1978; Hamermesh, 1978, *op. cit.*

[17] Deeper subsidization may or may not entail wider subsidization. In other words, we are not here discussing the allocation of total job creation funds between the public and private sectors but rather the level of subsidization per job.

[18] Currently, private sector subsidies are open-ended grants which encourage a substitution of labor for capital (or low-skilled for high-skilled labor) in the production of additional output. Public sector subsidies are closed-ended grants (block grants available by formula to each jurisdiction) and thus do not encourage employers to expand their use of low-cost PSE workers beyond what is provided for in the block grant. Some analysts have recommended that less than 100 percent subsidies be provided to the public sector but that the grants themselves be unlimited (see Gramlich in Palmer, *op. cit.*). Under an open-ended system, communities which were unable to use additional eligible workers efficiently, even at reduced costs, would not have to participate while those with unmet social needs which could be provided by PSE workers might expand their participation. If the productivity of some members of the eligible population is close to zero, which is what a 100 percent subsidy implies, then it is questionable whether they belong in a PSE program at all.

Finally, it may be easier to control displacement in the public than in the private sector. This can be achieved, for example, by requiring that CETA workers be employed on specially created projects. The disadvantage of this approach is that it may also reduce the value of the output which can be produced. It forces prime sponsors to use PSE workers to provide services that taxpayers are not normally willing to support.

Various efforts have also been made to control displacement in the private sector. Here, the major strategy has been to design marginal subsidies which only pay employers who expand employment beyond some base level. Some of the complexities involved in designing marginal employment subsidies are discussed in a paper prepared for the Commission by Professors Bishop and Haveman.[19] As they point out, it is difficult to design a program which is both marginal and categorical—that is targeted on the increased employment of hard-to-employ workers. One reason for this is a lack of information on a firm's employment of eligible groups in the base period. A similar problem besets PSE programs due to the lack of historical data on the characteristics of the employees of state and local governments and of community based organizations, broken down by their characteristics and whether they are CETA-supported or not. Without this kind of data (and even with it), it is difficult to say whether countercyclical job creation programs:

(*a*) Lead to any net increase in jobs for eligible groups as opposed to a movement of eligible workers from unsubsidized to subsidized job slots;[20] and

(*b*) Lead to any net increase in total jobs as opposed to a substitution of eligible for ineligible workers.

### IMPACT ON INFLATION

One final issue to be addressed is whether private sector subsidy programs are better inflation-fighters than public sector subsidy programs. There is not complete consensus on this question, but the following considerations appear to be relevant:

(*a*)—Entry level wages tend to be higher in the public than in the private sector, creating the possibility that PSE programs will force private employers to grant competitive wage increases which will be inflationary.

(*b*)—Lower labor costs are more likely to be translated into lower prices in the private sector.[21]

### LONG-RUN GAINS FOR PARTICIPANTS

Job creation programs, whatever their immediate effects on the employment and income of participants, do not necessarily improve the longer-term ability of these individuals to compete in the unsubsidized labor market. And since the duration of the subsidized employment experience is generally only for one or two years, any failure of the programs on this score may leave people no better off than before and call into question the wisdom of committing public funds to these activities.

It is hoped that the experience of having a job will improve the attitudes, work habits, and skills of participants and certify their employability, leading to higher earnings subsequently. Although some evaluations of both private and public job creation programs have suggested that such gains do occur, methodological problems inhibit placing too much credence in the results and certainly make it impossible to quantify any differences between the public and the private sectors on this score.

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[19] John Bishop and Robert Haveman, "Categorical Employment Incentive Programs: Issues of Structure and Design," processed.

[20] Note that data on the changing economic and demographic characteristics of CETA workers which are often advanced as indicators of the program's success are not generally accompanied by data on the changing characteristics of all government and CBO employees. Further, it is possible that the absorption of the economically disadvantaged and minorities into these two sectors has been accompanied by at least some decline in their participation in the private sector relative to what it would have been in the absence of PSE programs. Thus, an observed increase in the employment of minorities in PSE jobs does not necessarily mean that their overall employment has increased by as much. Their employment in nonsubsidized government jobs and in regular private sector jobs may be less than it would have been in the absence of the program.

[21] This occurs when employers hire additional workers to produce additional output which can then only be sold at lower prices. If lower labor costs in the public sector reduce sales or property taxes, this could also be anti-inflationary. But if they are used to expand public sector output, there is no corresponding reduction in measured prices. Whether there is a reduction in "real" prices or not depends on the value society puts on the additional public sector output. The ultimate effects in both cases also depend on how any initial reduction in prices or increase in market wages affects people's expectations about the future course of inflation.

More qualitatively, it is often argued that one clear advantage of private sector job creation is the fact that any skills acquired are immediately transferable to a permanent job within that sector and that the tax credits offered to employers operate as an effective recruitment and training subsidy. The fact that the training sometimes consists of learning how to fill a hamburger order is frequently mentioned as a possible problem. However, subsidization of nonentry level jobs does not seem particularly appropriate, given limited budgetary resources. Moreover, any attempt to combat this problem by introducing and then monitoring a significant training component is such programs leads to greater administrative complexity and the possibility that employers will reduce their participation. As we have seen, this lack of participation has been the Achilles' heel of past programs directed at the private sector.

### CONCLUSIONS AND POLICY RECOMMENDATIONS

Based on the foregoing review, the nation may wish to move toward achieving greater balance and articulation between the use of subsidies to provide jobs for the structurally unemployed in the public and private sectors:

(1) Currently (fiscal year 1979) $2.5 billion is obligated for counterstructural PSE to provide 275,000 fully subsidized jobs for the economically disadvantaged long-term unemployed. By contrast, it is estimated that less than $800 million is likely to be spent for the WIN, welfare and targeted job tax credits, even once they are fully implemented in fiscal year 1981.

(2) It would be possible to move toward common eligibility standards for these programs with a single agency (e.g., CETA prime sponsors) responsible for certifying eligibility.

(3) It is not clear why deeper subsidies should be provided to public than to private employers, unless public sector jobs are to be reserved for harder-to-employ groups or contain a larger training component. Current eligibility standards suggest that the private sector is being asked to hire the more difficult to employ groups with less financial incentive than is the case in the public sector.

(4) Both PSE and wage subsidy programs entail a substantial windfall gain for employers, which may or may not be passed on to citizens or consumers in the form of lower taxes or lower prices. Programs should be designed to minimize this windfall to the extent feasible, but some windfall is inevitable. These windfall costs may not be excessive given the potential social and economic benefits to be derived from putting people to work. Furthermore, there is no evidence that the net budget costs of producing jobs are inherently lower in one sector than in the other. If anything, the evidence suggests that job creation is less costly in the private sector.

(5) The fact that windfall gains in the public sector take the form of "revenue sharing" rather than "tax cuts for business" may make PSE more politically acceptable than private sector subsidization and could argue for directing more federal job creation dollars to the public sector. On the other hand, the fact that the absorptive capacity of the public sector is limited, that the value of additional public sector output may be low, and that the ultimate objective should be to move most of the structurally unemployed into the regular job market argues for more funding of subsidies for the private sector.

(6) The success of past private sector subsidy schemes has been inhibited by insufficient attention to informing employers about the provisions of the law, targeting which was viewed as overly restrictive, subsidies which were viewed as too small by employers, and administrative arrangements which were overly burdensome. Some of these earlier deficiencies have been corrected in recently enacted legislation. However, any regulations which are promulgated in connection with this new legislation and any future legislative initiatives should be carefully fashioned with these problems in mind. There is at least the possibility that such changes would make these schemes more attractive to employers and thus increase their utilization and ultimate effectiveness.

(7) Targeted programs, whether in the public or the private sector, are designed to improve the employment prospects of certain categories of workers. Many people are concerned that this may eliminate job opportunities for other groups of workers. However, appropriately designed programs can reduce total unemployment below what it would otherwise be at any given level of inflation. Therefore, the gains for subsidized workers need not come only at the expense of unsubsidized workers. At the same time, much more attention needs to be given to how to maximize the potential of these programs to effect noninflationary increases in total employment and output. These gains are uncertain at best and we have not learned very much about how to achieve them.

(8) In its Third Annual Report, the Commission expressed reservations about PSE as an employability development policy.[23] Similar reservations could be expressed about the ability of subsidized employment in the private sector to improve long-term employment prospects and earnings. Neither of these programs is likely to serve the needs of those with the most serious labor market handicaps. The latter need much more intensive counseling, remediation, and training. Thus, some "creaming" of more employable individuals is to be expected in job creation programs and should not be viewed as an undesirable outcome unless it also represents a pure windfall for employers.

(9) The above policy recommendations are directed toward some rationalization of public and private sector job creation programs for the structurally unemployed. A similar set of arguments could be advanced with respect to public and private sector job creation programs for the cyclically unemployed. With the demise of the NJTC at the end of 1978, the nation will have no general employment subsidy with which to counter any recession which might emerge over the next year or two. Some consideration might be given to adding a well-designed- nontargeted, temporary, tax credit which would subsidize increases in employment beyond some base level which varies with the overall state of the economy. Without such a program in place, and in the event of a recession, the nation might be forced to rely on countercyclical PSE or macroeconomic policy to a greater degree than is necessary or desirable. In addition, a general employment subsidy would help to offset the increases in payroll taxes and minimum wages scheduled for 1979 and subsequent years.

Senator BENTSEN. I have a note here that Congressman Brown is detained by the weather and will not be attending, but he has an opening statement which, without objection, we will put in the record at this point.

[The opening statement of Representative Brown follows:]

### OPENING STATEMENT OF REPRESENTATIVE CLARENCE J. BROWN

Mr. Chairman, I welcome the witnesses to this, the second day, of these very important hearings on structural unemployment.

The problem of structural unemployment is the most severe social and economic crises we have in this country today.

The problem most seriously hits the young and minorities. Teenage unemployment is, after four years of recovery, still above its pre-recession peak. Minority youth unemployment is measured, and I use the term loosely, at 35 percent. But, the truth of the matter is that the barriers are so strong and the opportunities so limited that too many of our youth simply leave the job market. Consequently, we can only guess at the rate of unemployed youth in the central cities. Some estimates run as high as 60 percent, and they represent a ticking bomb waiting to go off unless there is some easing in their desperate situation.

At the first day of hearing, we heard testimony that the private sector is needed to help the structurally unemployed. We heard that training was, in most part, the key to helping the structurally unemployed. We heard a great deal of support for subsidies attached to training. We heard support for the work of intermediate organizations and on-the-job training programs in the private sector.

But, what we must hear from Congress are new initiatives designed to aid the structurally unemployed. To help those people who are the unemployment statistics. To help those people who face the tightest of job markets. To help those people who are losing man's most important defense—hope.

Senator BENTSEN. One thing that I have learned in the time here is about the generation of ideas. In this committee, we get a lot of them.

They don't really begin to sink into the consciousness of many members, or certainly the public and the press, until they have been repeated many, many times, but they involve one issue that you and the others have worked on very much.

Mr. Hamermesh, will you proceed now, sir.

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[23] Third Annual Report to the President and the Congress of the National Commission for Manpower Policy, *An Assessment of CETA*, May 1978, p. 7.

## STATEMENT OF DANIEL S. HAMERMESH, PROFESSOR OF ECONOMICS, MICHIGAN STATE UNIVERSITY

Mr. HAMERMESH. Mr. Chairman, I have a prepared statement that I would like to present for the record.

Senator BENTSEN. Fine, without objection.

Mr. HAMERMESH. May I comment on some points already made.

I appreciate the opportunity to appear today. As you mentioned, I, and others, evolved the wage subsidy idea 3 or 4 years ago. I testified in 1975 before the committee in Chicago, and I think I was the only one who spoke in favor of the wage tax credits. It, and the other ideas, met with silence during the time of expanding public service employment programs.

Despite that, as you noted, 18 months later we had the New Jobs Tax Credit law on the books, and today we have the targeted program, which aims up to $3,000 per hire if they are in the categories of disadvantaged groups, welfare recipients, and others.

To have shifted rapidly from no policy to a general subsidy, to a categorical subsidy, requires that we be clear what we can expect expect from those policy tools.

I would like to analyze some conclusions I have come to on these various measures, and since the invitation letter asked for program recommendations, I would like to make a few program comments as well. I think those issues may be as important as the more general economic issues.

It appears to me that a wage subsidy like the new jobs tax credit is going to be ineffective when the economy is at or below the non-accelerating-inflation unemployment rate, as it is now. I differ from Ms. Sawhill on this, since I don't view a wage subsidy as a cheap way of lowering the inflation rate, today. It will lower labor costs and the employers may pass those savings on to consumers, but this subsidy involves a tax loss, and that loss has to be financed somehow. In most cases in the past, that has been financed by faster printing of money, and although I am not a complete monetarist, although I spent 4 years in Chicago, it seems to me this cost works against the benefits. I don't see these programs as doing a single bit for lowering the rate of inflation.

Senator BENTSEN. Let me ask you this: Some of these persons don't qualify for welfare payments. Isn't that a tradeoff?

Mr. HAMERMESH. There will still be some tax loss, and some additional financing has to be done.

Senator BENTSEN. But I would assume that there would be some contribution to the productivity of the country by taking this job as opposed to not working at all.

Mr. HAMERMESH. There would be more output, but I am not sure average output would go up. We could build scenarios where it would go down. The total would go up though, I am quite sure.

Nonetheless, I agree here with my colleagues that this kind of program is designed, and to me the most important thing at this point is to make sure it be available as a countercyclical device to be triggered by rises in the aggregate unemployment rate. If we had that, it would serve in its correct role as a countercyclical tool.

One way of doing this might be a trigger of a general wage subsidy, like the new jobs tax credit, to come into effect when the aggregate unemployment rate rises to about 7 percent, or some figure roughly around there. This would insure the subsidy would become effective only in periods that represent depressed business activity, when this would be appropriate as a countercyclical tool.

I agree with two previous witnesses, and also some of the people who spoke in your first series of hearings, that the targeted jobs credit can eventually only have small longrun impacts in reducing the unemployment rate without accelerating price inflation.

As Mr. Palmer noted, this is because most of the targeted groups contain individuals whose labor force involvement responds readily to job opportunities. What is going to happen is that the wage subsidies in most categories will induce individuals to enter the labor force, and the targeted groups' wages will be driven back to their original level. This does mean there will be more people in these groups in the labor force, and the groups' incomes will be higher. There may not be any unemployment rate impact, but there will be an overall earnings impact, which I don't think should be taken lightly. It is an important impact.

These are long-term effects, and to me they have been stressed far too much by those who analyze the issue. There are many studies by economists showing that, while the labor force responses are large, they take time to occur. This flooding into the labor force doesn't take place instantaneously.

The best evidence I can see is that over a period of from 1 to 3 years after a subsidy like this is initiated, one can have some impact on structural unemployment rates. This is especially true in those groups whose labor supply is less responsive to changed opportunities, and the impact on unemployment rates would be greater in the short run if more of the subsidy could be targeted toward those groups whose response to changed economic opportunities is less.

So I would recommend, therefore, that disadvantaged heads of households be placed on the list of targeted groups, since evidence suggests that household heads are relatively unresponsive to changed economic opportunities. If we could target on this disadvantaged group, we could have substantial impact on its unemployment rate without drawing many more people into the labor force.

These are general remarks, and I would like to deal now with a few programmatic issues.

People have spoken about the greater need to involve private employers. You yourself state that we almost have hidden the credit's light under a barrel, or did in 1977, on the new jobs credit law. In particular, the problem, I think, is that a lot of the knowledge of this is limited to financial officers—firms' officers who do the tax forms for the company, that is. But hiring is not done by financial officers. It is done by personnel officers. I think a direct outreach program toward personnel officers, those who are involved in doing the hiring, will have a substantial effect in making this thing more visible and also more effective.

Second, this is an issue that I think is——

Senator BENTSEN. The point you made, Congressman Brown made. He said he has a small business, and at the end of the year his tax man said, "Oh by the way, you have a tax credit here." I might be hiring a new personnel officer if I had a response like that.

But you are quite right. We ought to get it on the front end.

Mr. HAMERMESH. It is up to the employer to go to the Employment Service to get the people certified as being eligible. At least that is how I understand the regulations on this program.

Unfortunately, I have talked to several State employment security directors, including our own in Michigan. The employment security people don't feel themselves staffed up to deal with the deluge of requests for certifications they are going to get from various companies trying to take advantage of this program. Indeed, I can envision, if all efforts recommended by Dr. Palmer and myself come into effect, there will be a logjam.

For that reason, I think it might make sense to hold off pushing the program, at least for 4 or 6 months, until we can make sure that the Employment Service is meeting the certification requirements satisfactorily. If not, I can imagine private-sector employers getting very upset and washing their hands of the whole program because the Employment Service isn't doing the job that it may not in fact be equipped to do.

If nothing else, I think it should be monitored very closely and, if need be, reallocations required in the employment security mechanism so that more attention is given to the targeted employees.

Finally, there is a lot of stigma that targeting involves. Indeed, we saw in the 1960's under the JOBS program that a lot of firms wouldn't bother taking the credit. They wouldn't take the JOBS contract. They saw the people who qualified as being ipso facto not worthy of employment.

Senator BENTSEN. You are saying the individual himself didn't want that kind of classification put on him?

Mr. HAMERMESH. Partly that, and partly the employer, too. It in effect created a negative impact on the employment chances of the person.

I think one way to get around this, and this has been talked about earlier today, is that we should target to some extent for geographical areas, inner cities and depressed areas, rather than individuals. So I would recomment that if triggers are being talked about, that triggers be put into the program where the unemployment rate exceeds 5 percent, including areas like inner cities. I think with the new expansion of the Current Population Survey recommended by the Levitan Commission, we will have sufficient data to target more on geographical areas.

Senator BENTSEN. With respect to appropriations requested to enlarge the geographic sample distribution is it your feeling that the statistics we have on some of the targeted unemployment are not reliable enough? Do you have confidence in the validity of these statistics, or not?

As I look at these problems, and the computers were working in the last election on this, I feel we are not going deep enough into our statistical problems and I wonder if we have a full enough sample. Do you share that concern? I get feedback from some pretty explosive groups.

Mr. HAMERMESH. I think, given the size of the sample we are talking about, we are doing the best we can. I gather they are going to recommend expanding the sample substantially. We have had expansions, and we should get a better estimate by individual geographic areas.

Senator **Bentsen**. I think they are talking about another $36 million.

Mr. **Hamermesh**. I think another 20,000 households, or something like that. This would be 200,000 people being surveyed every month. This is substantial enough, I think, to give you a reasonable estimate for each area of the size of the unemployment rate among fairly narrowly defined demographic groups. I am fairly optimistic about that. If it is a structural program, it should be structured both in terms of demographics and also in terms of geographics, Aside from that aspect, it will have beneficial results on regional differences, which Mr. Palmer alluded to.

I would appreciate a chance to answer any more questions you have.

Senator **Bentsen**. We are very pleased to have you, Professor Hamermesh.

[The prepared statement of Mr. Hamermesh follows:]

## Prepared Statement of Daniel S. Hamermesh

### *Policy and Program Issues in Job Tax Credits*

Mr. Chairman, Members of the Committee: I thank you for the opportunity to appear before this body to discuss our wage subsidy policies. I testified before the Committee in October 1975. At that time I spoke in favor of private sector employment tax credits. My comments and those of others discussing this policy option were met with silence at a time of deepening recession and rapidly expanding public service jobs programs. Yet 18 months later we had on the books the New Jobs Tax Credit, (NJTC), a limited general wage subsidy titled toward low-wage workers. Today that has been replaced by the Targeted Jobs Credit (TJC), a categorical wage subsidy that allows firms nearly unlimited total credits up to $3,000 per hire if they increase hires of workers in such labor-force categories as disadvantaged youths, handicapped individuals, welfare recipients, and others.

With this rapid shift from no policy, to a general subsidy, to a categorical subsidy, we need to be clear on what we can reasonably expect from these policy tools. Achieving this clarity can then allow us to improve the structure of the TJC to enable it to meet its stated goals. The following general considerations appear paramount:

"A general wage subsidy like the NJTC is ineffective when the economy is at or below the nonaccelerating-inflation unemployment rate, as it is now. But such a subsidy should be available to be triggered by rises in the aggregate unemployment rate. It would then serve in its appropriate role as a countercyclical tool in the event of an economic downturn.

"The TJC can eventually only have small effects in reducing the unemployment rate without accelerating price inflation. After several years of operation, it will, though, increase the incomes of targeted groups by inducing increased employment and labor-force participation.

"The TJC can have beneficial short-term—say 1 to 3 year—impact on structural unemployment problems. This is especially true if the targeted groups consist of low-wage workers strongly attached to the labor force."

As now structured the TJC contains a number of features that militate against its success in achieving even the limited goals that I have outlined as appropriate. It could be improved by the following changes:

"Greater direct involvement of personnel departments. We saw in the 1960's that this was a necessity in efforts to increase the employment of disadvantaged workers.

"To remove part of the stigma that targeting confers on individuals, the credit should have a component aimed at geographic areas of high unemployment—inner cities and depressed regions—rather than being targeted solely to individuals with high probabilities of being unemployed.

"The Employment Service is not capable of handling the certification requirements of the TJC with its current staffing. Its funding should be increased to meet this need, especially because the TJC provides the employer, for the first time, an incentive to make use of the Employment Service."

Let me expand on these general and programmatic issues.

## I. GENERAL POLICY ISSUES

The best evidence suggests that the economy is now at or below the aggregate unemployment rate at which the rate of price inflation can be kept constant. If 4 percent unemployment was the accepted target in the early 1960's, 6 percent should be today: Changes in the structure of the labor force alone have added 1¼ percentage points, and expansions of various income maintenance programs have added another ¾ percentage point. In this economic environment a general wage subsidy cannot be effective in ameliorating inflation and reducing the unemployment rate, nor can it tilt the pattern of hiring to groups with severe unemployment problems.

One should also not view a general wage subsidy as a cheap way of lowering the inflation rate at a time when the economy is operating at the nonaccelerating-inflation unemployment rate. It will lower labor costs, and employers may pass the cost savings on to consumers in the form of lower product prices. But the tax loss produced by the subsidy must be financed somehow, and the accepted pattern for such financing in the past has been more rapid growth of the money supply. This monetary expansion will vitiate any beneficial effects on prices that the decline in employer-paid labor costs might have had.

I do not deny the usefulness of general wage subsidies. The evidence suggests that they were very helpful in expanding employment and lowering price inflation during 1977. They will be helpful in future recovery periods, and they should be available on a triggered basis to mitigate the severity of economic downturns. They are not, however, designed for periods of low unemployment, and they cannot be expected to lessen the economic problems attendant upon such periods. For problems of structural unemployment a structural remedy must be relied upon.

The Targeted Jobs Credit is an excellent potential structural remedy, but even its impact is likely to be limited. This is because most of the groups that are targeted are very responsive to changed economic opportunities and flow easily into the labor force when these improve. The TJC will initially expand demand for individuals in the labor force in the targeted groups, but evidence shows that others outside the labor force will enter the labor force and compete for the jobs created by the subsidy. While employment in the group will have expanded, the larger labor force will mean that the group's unemployment rate will not have changed much. Wage rates received by the employed will also be unchanged eventually, as the induced entrants compete them back to their pre-subsidy level. The only change will be an increase in the size of the targeted labor force and an increase in earnings (but not wage rates) in the targeted group.

These are long run impacts. The evidence suggests that, while the targeted groups' labor supply is responsive to changed opportunities, the response takes some time to become fully effective. Some recent work I have done with a simulation model of labor-market adjustment in the presence of a wage subsidy suggests that this lag and other labor-market lags enable the subsidy to maintain half of its initial effect for roughly three years. The duration of the effect depends, as the numbers in the Table below indicate, on the assumptions made about the speed of labor-market adjustment. But using the best available estimates of the parameters describing this phenomenon, we may conclude that there is some scope for a short-term reduction in unemployment rates.

NUMBER OF YEARS BEFORE HALF OF THE INITIAL IMPACT OF A WAGE SUBSIDY DISAPPEARS

| | Labor market adjustment | | |
|---|---|---|---|
| | Slow | Medium | Fast |
| Employment | 10 | 3 | 2 |
| Wage rates | 8 | 4 | 2 |

Producing a permanent impact on unemployment rates requires that the targeted groups' labor supply be unresponsive to changed opportunities. Unfortunately the econometric evidence implies that this is not true for most of the groups targeted by the TJC. For a targeted credit to achieve a longer-term impact on unemployment rates, it would have to be targeted toward groups with a strong labor-force attachment. Among the groups now targeted only Vietnam veterans are likely to be in this situation. As an addition low-wage heads of households should be singled out for special targeting, since the evidence suggests that household heads are strongly attached to the labor force. This would create jobs for persons with low family incomes, and the economic reasoning shows that wage subsidies targeted to this group have the best chance of achieving a long-term impact on unemployment.

Even if there is no permanent impact on unemployment rates, and the TJC just shifts people from work at home to work in paid employment, a strong case can still be made in its behalf. The growth of Social Security and income taxes, and the increased cost of commuting, have placed a large wedge between the value of a dollar of gross pay in employment and a dollar's worth of production at home. To some extent the TJC, by increasing demand for workers in the targeted groups, can remove part of this wedge and reduce the inefficiencies caused by the system's bias against production in the market.

The available evidence shows that low-wage workers are quickly hired in fairly large numbers when their wage cost is lowered. There is some fairly weak evidence for this among individuals with little formal education, and two recent studies using totally different data strongly support this statement as it applies to youth employment. As the Table below shows, a small cut in the wage cost of youths drastically increases employers' demand for young workers. However, as the Table also shows, there are also significant cuts in employment of other workers initially in response to the drop in the cost of employing targeted youth. Targeted youths and others appear to be su[illegible]tuted for those not targeted. This negative secondary effect means that, to so[illegible]ent, jobs "created" in the 1 to 3 years during which a TJC can have an impa[illegible]employment in the targeted groups do not represent net job creation, but are instead a reflection of reduced employment in the nontargeted groups. While the TJC can have a major short-term impact on the employment of low-wage workers, at a time when the economy is operating with a tight labor market part of the apparent impact represents a redistribution of rather than a net gain in employment. Of course, redistributing employment opportunities may be a worthy short-term policy goal, but it is not the goal the TJC was to be aimed toward.

Another worrisome negative secondary effect is that the credit biases employers hiring decisions against workers who have acquired more skills. This is OK initially, for it is precisely the low-skilled, low-wage individual whom the program seeks to help; but it eventually means that the growth in skills embodied in the population will slow and average living standards will rise less rapidly.

INITIAL RESPONSE TO A 1-PERCENT WAGE SUBSIDY TARGETED TO YOUTHS

[Percentage change in employment]

| | Time-series data | Census data, 1970 |
|---|---|---|
| Youths | +7.1 | +9.7 |
| Workers, 25 to 44 | -.3 | -.7 |
| Workers, 45 and over | -.2 | -.7 |

This problem is inherent in any wage subsidy geared toward the low-wage worker. Partly it is solved by the TJC through the use of the two-year eligibility provision. To remove still more of the problem people who have received skills training under CETA (not people employed under CETA-PSE) deserve special consideration as an additional target group. Aside from its benefit in enabling the TJC to avoid offering additional disincentives against undertaking training, this proposal has the added virtues of clarifying the linkages between our various employment policies and of underlining the importance of the acquisition of skills to the long-term growth of the economy.

A large amount of recent research has claimed that much of the unemployment problem is the result of labor force turnover, as individuals in some demographic groups move between jobs and in and out of the labor force. The TJC can reduce this type of unemployment over the short term by providing incentives (through the two-year benefit duration) for employers to retain workers qualifying for the credit. In this view the essential thing is to ensure the worker's attachment to the labor force.

Without going into the relative merits of the two proposals from an administrative viewpoint, I believe that on economic grounds the objective of stabilizing employment and labor force attachment can also be achieved by offering the subsidy directly to the worker. This would involve giving job vouchers to individuals in the targeted groups and letting them redeem the vouchers with employers of their choice. This brings home to the worker directly the aid the program provides to him or her, and it enhances the visibility of the subsidy to the personnel manager who does the hiring. I believe it might improve the short-term effectiveness of the subsidy. I stress, though, that it would not change the long-term impacts: These depend, as I noted before, on the eventual supply responses of eligible individuals not usually in the labor force, responses that seem to be so large as to suggest that the long-term impact will still be on the groups' earnings, not on unemployment rates.

## II. PROGRAM ISSUES

Although we have seen that the major long-term impact of the TJC will likely be to increase earnings rather than change wage rates or unemployment rates, this goal may be desirable on an equity basis. Further, the short-term employment gains that can be achieved through appropriate targeting and structuring of the subsidy are important, and the program should be tailored to increase the likelihood of achieving them.

The impact of the TJC will be less than the maximum possible if knowledge of its benefits is restricted to the individual who fills out a firm's tax forms. We saw in the first six months of the NJTC that it took some time before even the financial officers of most corporations were aware of the credit. With the complexity of the targeting under the TJC, and even with the incentives it provides personnel officers to become involved as they attempt to certify their new hires, similar or even longer lags are highly likely in this program.

To facilitate the use of the credit and increase the immediacy of its effectiveness the Department of Labor should become directly involved—in an active rather than reactive way—in making personnel managers aware of the gains that can accrue to them from the subsidy. Both a national advertising campaign and direct involvement at the local level, with Employment Service officials actively recruiting local employers to hire targeted workers, should be undertaken late this year to increase the short-term employment effects of the TJC.

Even if no active efforts are made by the Employment Service to recruit employers to take advantage of the credit, the Employment Service will automatically become heavily involved with the TJC in its capacity as the certifying authority. This will clearly involve a substantial increase in contacts between employers and the ES, as the former attempt to discover which of their hires qualify them for the tax credit. For the first time private employers will face a large financial incentive to use the ES. Hopefully these enlarged contacts between private employers and the nation's largest job-placement agency will improve the ES ability to place even those hard-to-employ workers not directly targeted by the TJC.

Whether this increased burden can now be met by the Employment Service is an open question. I envision local offices being swamped with requests for certification of individuals' eligibility for the TJC, especially now as the backlog of hires (built up since late September 1978) must be certified. If the ES cannot certify workers' eligibility rapidly and the backlog continues to grow, employers will give up on the program as "another bureaucratic nightmare," even though the Employment Service is not directly at fault. To have the program discredited ab initio solely because a flood of back claims for eligibility must now be certified would be a horrible waste. Recources should be shifted within the ES, and extra resources should be given to the ES to meet its enhanced responsibility of certifying TJC eligibility.

A major program issue is whom to target or what categories to target. We should subsidize the poor and the low-skilled, but we do not want to subsidize low skills. (This detrimental supply-side effect works in the same direction as the demand-side effect noted in Section I). If at any time we subsidize low skills, we will induce people to become low-skilled. All the evidence I have seen suggests that relative supply elasticities to occupations are very high. People do respond if we create opportunities or incentives for them to become low-skilled or to invest less in themselves. Unless the credits are targeted with care, there will be a lot less investment in skills.

A way to get a handle on this is to use the distinction between characteristics that are inherent in an individual, indexes, as opposed to signals, things that people invest in themselves that can convey information. We should aim the credits toward things that are indexes, that cannot be changed by the individual, rather than things that can be changed. For example, age is an index: It is hard for me to change my age. Handicap status is another one, as is veterans status. Things like AFDC status, length of unemployment, and food stamp status are very easily changed. If we target on these, we will provide an incentive for people to switch into these categories. How big this effect is, I do not know, but it is there.

It would be sensible to target the credits to some groups based upon indexes like age and handicap status, but also target them toward areas of high unemployment. That way there is little incentive for individuals to become unemployed longer, but those areas that contain a lot of unemployed individuals are going to be the ones where the credit is available, either longer or in larger amounts. Geographical targeting, aside from any benefits it may confer in the form of aiding depressed regions, is a good means of preventing any detrimental secondary effect on the amount of training undertaken. It also helps remove part of the stigma that may accrue to an individual targeted by the subsidy and may prevent his being hired. (This is one of the possible causes for the relatively small employer interest in the JOBS contract program in the late 1960s.) If any modifications of the TJC are to be made, inclusion of a geographically-targeted component of the subsidy would rank highest on my list.

One easy way of implementing this recommended change in the TJC is through local area triggers: Benefit levels could be set at 30 and 15 percent of FUTA wages in the two years of eligibility in areas where the total unemployment rate is below 7 percent, and at 60 and 30 percent in areas where it is above this figure. This trigger, linked to the structure of geographical differences in the degree of labor-market tightness, is the appropriate one for a program that is intended as a structural measure. It channels the greatest aid to those areas where measured needs are greatest, and it does this with relative administrative simplicity. Alternatively, the current subsidy could be triggered in an area only if its unemployment rate rose above 5 percent.

While a local area trigger might make sense for a general wage subsidy, the additional benefits of preventing the disincentive to acquire skills and removing part of the stigma of individual targeting are not present. Thus the case for geographical triggers on a general subsidy is much weaker than on a categorical subsidy. The general wage subsidy is best considered as a countercyclical device like PSE jobs or tax cuts. As such it should be at the ready in the arsenal of anti-recessionary job-creating measures. To do this a national triggered general wage subsidy, perhaps a triggered version of the now-expired NJTC, tied to increases in the aggregate unemployment rate above 7 percent, is worth considering. Our experience with employment tax credits in 1975–77 shows that, while they were successful, their implementation became part of a larger legislative process, and their effectiveness was delayed because of this. A standby triggered general subsidy would obviate this potential problem in any future cyclical downturn.

I have no quarrel with the benefit levels or duration contained in the legislation authorizing the TJC. The former provides a large enough incentive to induce employers to take advantage of the subsidy, while the duration is long enough to prevent the churning of employees that might increase the instability of employment and decrease individuals' investment in on-the-job training. More important even than these is the limitation on the credit to the $6,000 FUTA tax base. The cap on the credit per worker is the best way of preventing the credit—targeted toward low-wage workers within particular groups—from becoming a more general wage subsidy. Were the cap to be raised we would face problems of employers "creaming" high-wage workers within targeted categories, for the percentage wage subsidy would be the same for them as for lower-wage targeted workers. The credit maximum of $3,000 is a good way to prevent such "creaming" and the possible perversion of the program into a subsidy for middle-income workers. As long as the FUTA base remains roughly half of average earnings, the base should remain the limiting factor on the size of the credit employers may claim.

As we have seen, Mr. Chairman, the Targeted Jobs Credit is not a cure for today's problems of structural unemployment and inflation. It can, though, effect a short-term reduction in the unemployment rates of the hard-to-employ, and it can achieve a long-term increase in the incomes of members of the targeted groups.

These are important achievements, and they alone provide sufficient basis for applauding the introduction of this structural program. Moreover, their importance requires that the TJC be given a chance to have these impacts through efforts to involve private-sector personnel departments, aid the Employment Service in its expanded role under the TJC, and avoid negative secondary effects by tying the credit to local area unemployment triggers. While not a panacea for structural unemployment problems a well-administered Targeted Jobs Credit can become a useful private-sector program aimed at low-wage workers that provides a counterbalance to our vast public-sector jobs programs.

Senator **Bentsen**. Mr. Doeringer, will you please proceed.

## STATEMENT OF PETER B. DOERINGER, PROFESSOR OF ECONOMICS AND DIRECTOR, REGIONAL INSTITUTE OF EMPLOYMENT POLICY, BOSTON UNIVERSITY

Mr. **Doeringer**. Thank you, Mr. Chairman. I welcome the opportunity to address the committee this morning, particularly because I believe the requirement which the Congress imposed upon the committee to review employment policy in this fashion is a very important step in focusing on the fact that manpower or employment policy in this country must be viewed much more in the future than in the past in the context of a broader economic policy.

I think the committee that has general oversight responsibilities with respect to the functioning of the economy should be paying particular concern to the role and operation of labor markets in employment policy.

When we have thought about employment policy in this country, our thinking in the structural area has focused on the fit between people and jobs. The "people" approach has stressed training, counseling, information, and relocation to improve employability. It has been one of our cornerstones of employment policy since 1961. The "jobs" approach has focused upon stimulating economic development through tax incentives and public works projects, and more recently through direct job creation and public service employment.

The success of these programs or even what standards ought to be used to judge the success of these programs is a matter of considerable debate. My interest in testifying before the committee today is not to join in this debate, but rather to outline for you a view of the labor market and of labor market structure and of programs to remedy the effect of structural imbalances in the labor market. I wish to examine that process and suggest that our historical view of structural imbalances has perhaps been too narrow a guide for employment policy. We should try to develop a somewhat fresher view on what labor markets are and what imbalances in this country are like.

Now, when we look at numbers—which, after all, has been the focus of most of our employment policy—we find that unemployment has been mentioned by a number of people on this panel. It can mean many different things. It may symbolize the temporary or permanent displacement from work. It may be the result of the first job search, or reentry into the labor market after some period of being outside it, or it may reflect the transition to a better job.

More often than not, however, when we focus on unemployment rates, it tells us very little about structure of the labor market. It tells us very little about what has produced this unemployment, and where this experience of unemployment fits into the lifetime career of the worker. While unemployment is a very useful guide to national economic policy, I think it a very poor indicator with respect to the function of the local labor market which the employment policy is designated to affect.

There has been a lot of recent academic thinking on how labor markets operate, and this has focused much less on unemployment than on workers' earnings over a lifetime. This work, I think, is important, because it seeks to judge labor market performance over a long span of time; over a working lifetime; over a work career; rather than taking a one-shot look at unemployment in the economy. It seeks to identify what factors influence long-term employability.

I think you will find, Senator, that there is a fair amount of disagreement as to the interpretation of the facts that these studies have developed. But, there is a fair amount of agreement over the facts themselves. One of the facts is that education and training are correlated with income. The second fact is that there is a lot of what is called crowding in the labor market. The idea that certain groups which have been the focus of manpower policies historically—the disadvantaged, minorities, women, and youth—tend to be crowded into certain sectors of the economy, in certain occupations and certain types of companies, rather than being spread evenly throughout the economy.

The other point is that beyond school, beyond training in CETA programs or the Armed Forces, that the very act of being at work and in the labor market contributes substantially to income improvement over time. But this improvement is better for white adult males than for other groups in the economy.

I think, consistent with these facts is a story—that I have developed in my prepared statement—a story which says that certain groups of workers—the advantaged workers—participate in the primary labor market, where training occurs on the job, where careers are made, and where income improvement occurs with relative predictability over time. Other labor force groups tend to remain in what I call the secondary labor market where jobs are erratic, where they are dead end, where one sees the source of much unemployment and much in the way of low-wage jobs.

I think this view of distinguishing between primary and secondary sectors on the job side of the labor market is particularly helpful in focusing policy on two kinds of questions.

The first question is, What are the factors that control access to the better jobs in the primary sector? The second question is, What controls the mix in the job market between primary and secondary opportunities; a question which is addressed much less frequently.

Because of the policy concern in this country with unemployment, unemployment rates, and unemployed workers, policies tend to concentrate much more on access to jobs. Even when we have had a jobs policy itself, it has focused on jobs per se, without regard to the underlying structure of the market, without regard to whether or not jobs are being created in the primary sector or secondary sector, and without regard to whether they lead to primary or secondary sector employment.

It seems to me the training policy in this country has been most often judged by its ability to take an unemployed worker and put that worker into a job, regardless of in what sector of the economy that job lies. When jobs are created, again, the distinction between primary and secondary employment was neglected. Employment policy has been oriented around people, without developing the idea that we should be targeting on certain types of jobs and employers, particularly those that lie inside the primary sector. Our training programs should be targeted in getting workers in those jobs, and our economic programs should be targeted on expanding primary sector jobs rather than secondary sector jobs.

Why have we neglected this distinction? It is partly a matter of expediency, and partly a lack of resources. But I would argue most importantly that it is our national attitude toward structural change itself. As a nation, we have usually tended to react to and defend against structural changes of the economy, rather than to promote it. Our employment policy has been to cushion the impact of structural change in the labor market.

This goes back to the Area Redevelopment Act, which was trying to ease the burdens of economic decline in certain areas. It goes to the Trade Expansion Act, which was designed to cushion the impact of foreign competition on certain workers, and to the experience in MDTA, which was to rescue declining central cities. In each case the policy has acted to avoid an unwanted end result, but we have not sought to——

Senator BENTSEN. It somewhat prolongs the problem, doesn't it?

Mr. DOERINGER. It does, indeed.

As you will see, I am developing a thesis that says one may have to create a set of problems, a certain amount of structural change, to get us out of our stagnation. I think what is ironical with our manpower policy historically is that its origins can be traced to origins on the European Continent, particularly in Sweden, where there was a vastly different approach to structural change.

In the 1950's Sweden had developed a manpower policy that in its terms was extraordinarily successful in dealing with structural imbalances in the labor market. But at the time the Swedes were pursuing a policy of structural change as a result of their pursuit of full employment, and as the result of a nationally negotiated minimum wage program which was raising the lower incomes in the country faster than the average.

The effect of these policies was to squeeze, erode, and eat away at what I described as secondary employment in Sweden. The effect of that erosion was on the one hand to improve earnings and productivity and economic performance in the country and, on the other hand, to displace workers from these low wage, dead-end jobs.

The economic benefits were obvious. What one needed in the face of these economic benefits was a program to assist with and ameliorate the effects of deliberate structural change and the worker displacement which occurred as the result of that.

The United States adopted what was essentially the Swedish approach, but did so to combat, not intentional or desired structural change, but rather these unwanted structural dislocations which were operating in an economically slack environment. Where the Swedes sought to promote change, we sought to minimize the change that occurred.

The thesis that I would propose today to the committee is a departure from where our employment policy has been. The thesis that

I would propose is that we need to go back to the drawing board with our employment policy, and think of ways that employment can be expanded in the primary sector at the expense of the secondary sector. We need to change the mix we find in the economy today between good and bad jobs.

This is really critical if we are to have an employment policy that is not directed as simply moving workers from the category of unemployed to employed. It is directed at improving the productivity and income of the labor force.

Employment in the secondary sector will do little to upgrade long-term skills—little to upgrade the earnings and productivity. Programs that give some workers new access to the primary market and to the career opportunities it contains also runs the risk of displacing workers already there, or already headed in that direction, unless there is a net growth in primary sector jobs.

There are always niches that can be filled by workers without displacing others, but if you think of a major program, not just unemployment, but low wages, are a problem. The larger the program, the more the risk of this displacement.

I would argue that the challenge to employment policy in this process is to define the tools that will help us bring about deliberate and positive structural change. The Swedish experience suggests that such structural change can be promoted through full employment. Competition gradually drains away the unemployed workers, and stimulates the transfer of workers to the primary market. Employers find ways to adapt and train the hard to employ with or without the assistance of public policy.

Secondary sector jobs in this process either get upgraded, improved, or paid more for. Otherwise, they disappear from a simple lack of labor to fill them.

Because of fears of inflation, the United States has really never tested this European experience of full employment in the Swedish sense, at least not during peacetime. There is, however, evidence that these forces were in effect in this country during the boom of the 1960's.

It seems to me that our present arsenal is rather skimpy. We could pursue what the Swedes did, a minimum wage policy which would tend to price secondary employment out of the policy, but this supposes a full employment policy.

Senator Bentsen. Your time has expired. If you would summarize, I would appreciate it.

Mr. Doeringer. Yes.

Senator Bentsen. Would you summarize, please?

Mr. Doeringer. Yes; let me restrict my closing remarks to the question of where employment policy fits, where a policy like CETA or its successor, whatever that may be, would fit.

It suggests first of all that the principal aim of employment policy is economic development, a targeted economic development policy directed at the primary sector types of jobs. The role of CETA should not be as a safety net. Instead, it should serve as part of a program for economic revitalization. It is an arm of policy that would provide the human resource development programs, targeted on people with difficulties in getting into the primary sector, and would provide the assistance to facilitate the absorption of workers into this sector. Second, its jobs program could play a role in finetuning local economies.

Perhaps even more important, however, is that I see the CETA system as performing two roles. One is to stimulate labor market by innovation. As we know from any investment program, whether it is a private investment program or a public investment program, the payoff of that program can be substantially improved if it is combined with a good idea. CETA has provided an opportunity for research and development of good ideas, and has improved our basic understanding of how labor markets work.

Perhaps the most important function of CETA, and one which I believe is independent of how employment policy is delivered in the future, is the role of the CETA system as an economic monitoring and planning system. It seems to me that CETA represents our only national network engaged in a program of local economic analysis. CETA planning machinery now in place has the capability of monitoring a very wide range of Government activities which impact on the economic process, ranging from regulatory activities to local fiscal policy. I think any national policy of economic revitalization must rely heavily on imputs of business, labor, and local governments. Without a local planning agency these plans for the national economy cannot be fully realized.

Thank you.

Senator BENTSEN. Thank you, Mr. Doeringer.

[The prepared statement of Mr. Doeringer follows:]

## PREPARED STATEMENT OF PETER B. DOERINGER

### *Unemployment, Labor Market Structure, and Employment Policy*

### I. INTRODUCTION

Thinking about employment policy in this country has been dominated by a concern with unemployment and its causes. Often these causes have been traced to some notion of structural imbalance in the labor market. Thus we think of the youth or the minority or the veteran's employment problems as one of a poor "fit" with the job structure of the economy. Or we think of depressed or declining areas where the disappearance of jobs has upset the labor market balance.

From this perspective, employment policy can be directed either at people or jobs. The "people" approach stresses training, counselling, information, and subsidies to improve employability—the cornerstones of U.S. structural labor market policy since 1961. The "jobs" approach has focused upon stimulating economic development through tax incentives and public works projects, and more recently through direct job creation.

Whether or not these programs have been successful, or even what standards should be used to judge success, have been matters of considerable debate.[1] My interest today is not to join in this debate, but rather to outline why this view of labor market structure, and programs to remedy the effects of structural imbalances, is too narrow a guide for employment policy.

### II. A NEW VIEW OF LABOR MARKET STRUCTURE

Labor markets are constantly in flux. New companies are formed and bankruptcies occur. Firms grow, decline, merge and relocate. Workers enter and reenter the labor market, change jobs and careers, and they retire and are replaced. Our training systems and employment systems have built into them considerable flexibility to accommodate such change.[2] Employers can rely upon many types of labor reserves to meet surges of employment and workers develop various "shelters" against labor market adversity.[3]

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[1] See Farrel Bloch (Ed.), "Evaluating Manpower Programs" (Greenwich, Conn.: Jai Press, 1978) and Congressional Budget Office, CETA Reorganization Issues (Washington: GPO, August, 1978).

[2] See, for example, Peter B. Doeringer and Michael J. Piore, "Internal Labor Markets and Manpower Analysis" (Lexington, Mass.: D.C. Heath Co., 1971).

[3] Marcia Freedman develops the concept of shelter in "Labor Markets: Segments and Shelters" (Montclair, N.J.: Allanhold, Osmus and Co., 1976).

Unemployment in such circumstances can mean many different things. It may symbolize temporary or permanent displacement from work. It may be the result of a search for a first job or part of the transition to a better job. It may have been predictable and planned, or it may have been accidental. Because of these ambiguities, more often than not, observed unemployment tells little about the underlying structure of the labor market and how that structure is changing. While useful as a guide to national economic policy, unemployment rates are a poor indicator of the structure and performance of local labor markets.[4]

Much recent academic thinking about labor markets has focused upon earnings and career patterns rather than unemployment. This work seeks to judge labor market performance over a worker's lifetime, instead of one point in time, and to identify what factors influence long term employability.[5] The crucial policy question is whether labor markets are meritocratic—rewarding ability and skill with some accuracy—or are governed by institutional forces which systematically affect the employment prospects of certain groups.

There is considerable agreement about certain facts of labor market behavior. One is that education and training are correlated with income. A second is that considerable "crowding" exists whereby youth, minorities, and women are concentrated in certain occupations rather than being spread evenly through the job structure. A third is that work experience contributes substantially to income, but that this effect is much more important for adult, white, males than for other labor force groups.[6]

Consistent with these facts is the view that white males gain access in their early twenties to the primary labor market—the market containing jobs that have career potential. Other labor force groups remain concentrated in the secondary labor market where prospects for career advancement are more slim.[7] This distinction between primary and secondary labor markets provides a framework which can be useful while thinking about how to shape labor market policy. In particular, it emphasizes that policy must be directed at three separate concerns: (1) the mix between secondary and primary employment opportunities in the economy; (2) the factors controlling access to primary sector jobs; and (3) the factors controlling individual career paths through the primary sector.

## III. EMPLOYMENT POLICY AND THE DUAL LABOR MARKET

Because of its concern with unemployment, per se, employment policy has concentrated on preparing people for jobs without much attention to the dual or segmented structure of labor markets. Despite rhetoric to the contrary, training policy has been most often judged by its ability to take an unemployed worker and place that worker in a job regardless of whether the job is in the primary or secondary sector. When jobs were created, either through economic development efforts or through public service employment, the distinction between primary and secondary employment was again neglected.[8]

Employment policy has always been targeted on people—disadvantaged or unemployed—and toward high-unemployment areas. Ironically, job targeting has never been tried.

The reason for this neglect can be traced to many sources: lack of basic knowledge of labor market functioning, program expediency, and lack of resources, to name a few. Those, however, are incidental to a larger issue of our national attitude toward structural change.

As a nation, we have always chosen to react to, and defend against, structural change rather than to promote it. Our employment policy has been used to cushion the impact of structural changes in labor demand. Its origins in the Area Redevelopment Act testify eloquently to the concern with easing the burdens of economic decline. The training provisions of the Trade Expansion Act dealt with dislocations induced by international competition. MDTA was first used to offset the impact of automation and then to rescue declining central cities. More recently, changes in the demographic structure of the labor force have spurred programs for the youth labor market.

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[4] See National Commission on Employment and Unemployment Statistics Final Report (1979) and Glen Cain, "Labor Force Concepts and Definitions in View of Their Purposes," in Commission Background Paper No. 13 (1978).

[5] See, for example, Herbert S. Parnes, "The National Longitudinal Surveys: Lessons for Human Resource Policy," Report to the U.S. Department of Labor, ETA, Office of Research and Development (1976, Mimeo).

[6] Robert Hall, "Why Is the Unemployment Rate So High at Full Employment," Brookings Papers on Economic Activity, No. 3 (1970).

[7] Doeringer and Piore, *op. cit.*

[8] Only with the recent CETA amendments is employment policy obliged to address income improvement as a goal.

Ironically, our employment policy can be traced to a vastly different approach to structural change. In the 1950's, Sweden had developed a highly-advanced and successful labor market policy directed at structural imbalances in the labor market. The Swedes had been pursuing a deliberate policy of structural change in their labor market by combining an aggressive policy of full employment with a nationally negotiated wage policy designed to raise minimum wages faster than average wages.[9] The result was to gradually squeeze their secondary labor market out of existence. Their manpower policy was to take workers displaced from secondary employment and to transfer them to the primary sector.

In contrast, the U.S. adopted these policies to combat unwanted structural dislocations in an economically slack environment. Where the Swedes sought to change the structure of the labor market, the U.S. sought to minimize structural change.

## IV. STRUCTURAL CHANGE, FULL EMPLOYMENT, BOTTLENECKS, AND INFLATION

Avoidance of structural change has sapped our economic vitality. It has fostered policies, such as trade protection, which allow us to defer hard economic choices and divert attention from the search for better solutions. What is needed is a new commitment to structural change—to the expansion of the primary sector and the contraction of the secondary sector. Such a "jobs" policy is critical to improving the income and employability of the labor force. To the extent that our current programs further employability in the secondary sector, they will do little to upgrade the long term skills, productivity or earnings of American labor. Programs which give some workers new access to the primary market, and to the career opportunities contained therein, risk displacing other workers from primary employment unless there is net growth in primary sector jobs. These displacement effects will vary with program size and the level of unemployment. The challenge to policy is to find the tools needed to bring about such a deliberate structural change.

The Swedish experience suggests that such structural change can be promoted through full employment. Competition in a tight labor market gradually drains the labor reserves of unemployed and underemployed workers and stimulates the transfer of workers from secondary to primary employment. As labor markets tighten, barriers to employment melt and employers finds ways to train and adapt the hard-to-employ. Secondary sector jobs either get upgraded or disappear from lack of labor to fill them. Because of fears of inflation, the U.S. has never tested persistent full employment in the Swedish sense during peacetime. There is, however, evidence of similar forces at work in this country during the boom of the 1960's.[10]

A counter argument to this view of full employment as an engine of structural change is often advanced. It maintains that the labor force, and not the job structure, is the major constraint on employment policy. This view holds that the supply of primary workers would be exhausted long before full employment could be reached. The resulting bottlenecks in the primary labor market will then create wage inflation which will imperil further growth. This prognosis, however, rests largely on theory rather than being tested against experience. Moreover, it does not argue against structural change so much as it points to the inadequacies of our capacity to understand and combat inflation.

Are there any alternatives to full employment as an approach to structural change? At present, our policy arsenal is skimpy. Using the minimum wage to "price" secondary employment out of the market, as was done in Sweden, presupposes a full-employment policy to reabsorb displaced labor. Other policies aimed at directly diminishing the secondary sector suffer from a similar drawback.

A second possibility is to convert secondary sector employment into primary sector employment. Such "institutional engineering" has not been deliberately attempted apart from some experiments with job redesign. Yet there are some directions to be explored. Primary sector employment has certain characteristics that distinguish it from the secondary sector. Jobs are relatively stable; they are often located in medium to larger size firms with some degree of market power; they are often unionized or are governed by equitable personnel policies; they provide training and advancement opportunities; and they have compensation arrangements that discourage labor turnover. This suggests that policies to encourage unionization, particularly along industrial lines, in the secondary sector; to foster the stability, growth and merger of small enterprises; and to encourage more effective personnel development within smaller enterprises may assist in converting secondary into primary employment.

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[9] T. L. Johnston, "Economic Expansion and Structural Change: A Trade Union Manifesto" (London: George Allen and Unwin, 1963).

[10] Arthur Okun, "Upward Mobility in a High-Pressure Economy", Brookings Papers on Economic Activity, No. 1 (1973).

The third approach is to use public policy to promote primary sector employment. Because stability and predictability are important in the primary sector, contracting schedules could be sequenced so as to stabilize production and employment. Tax incentives to business development could be directed at primary rather than secondary firms. Public service employment aimed at structural problems must explicitly be linked to main-line government jobs in order to assure career employment.

These proposals, while speculative, suggest that there is room for manipulating economic structure. Moreover, strengthening the primary sector can contribute to worker productivity and to long-term economic performance. This will lessen, rather than increase, inflationary labor market pressures.

## V. EMPLOYMENT POLICY AND ECONOMIC REVITALIZATION

Where does employment policy, and CETA in particular, fit into this policy scheme?

My own view is that CETA should stop being used as the principal safety net between jobs and income maintenance. Instead, it should become an active arm of a national Program For Economic Revitalization. Such a revitalization program would not only use national policy to set employment levels, but would also be concerned with the composition and geographical location of economic activity.

This proposal is not as radical as it may sound. Many of its elements are already embedded in our nation's economic policies. Federal aid to depressed areas, small business subsidies, environmental regulations, and state and local investment incentives are all pieces of a targeted development program. Tariff and trade policy is continually concerned with regulating the rate of decline of jobs and institutions in industries such as textiles and shoes. Control of industrial organization and structure are implicit in our anti-trust and merger policies. The TVA, Conrail, and Amtrak are examples of national involvement in sectoral planning. Wage and price policies are becoming a perennial activity of government.[11]

What is new about this approach is the idea that the scattered policies that impact upon economic development might be coordinated, and that this coordination might pay attention to the implications of growth for labor market structure. CETA provides two important functions in this system of coordination. Programmatically it can allocate resources to provide the human resource component of the economic revitalization program. Human resource development efforts would aim at the absorption into the primary sector of those with employment disadvantages. CETA's job component could also help to fine tune the balance between workers and jobs in the local economy.

Of greater importance, however, is the role of the CETA system in economic monitoring, planning and innovation. If human resource development programs are analyzed in investment terms, a payoff of 10–15% would be considered a good return. Investing $4,000 in a trainee, for example, might be expected to yield $400–$600 per year in additional income to the trainee. As with capital investments, however, this yield can be substantially improved if combined with an invention or innovation. CETA has been and should continue to be, in the business of research and development into new ways to train and utilize labor.[12] Without this capacity for innovation, employment policy will stagnate.

An equally strong case can be made for the CETA planning system. CETA now represents the only national network of government agencies engaged in local economic analysis. The CETA planning machinery has the capability to monitor and analyze the implications of a wide range of government programs ranging from vocational education to regulatory and fiscal policy impacts. Any national program of economic development must rely upon business and labor at the local level for its implementation. Without a local planning mechanism that can incorporate local labor, business and governmental inputs, development plans for the national economy cannot realistically be developed.

Senator **Bentsen**. The experience that you have had in working with local labor markets, such as in the New England market, educated me a little on how the employment provisions of the States work.

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[11] Martin Feldstein, "Lowering The Permanent Rate of Unemployment," Joint Economic Committee; Congress of the United States (September 1973).

[12] See, for example, "Manpower Report of the President, 1975," pp. 95–96.

In Texas, as I understand it, there is a lot of Federal funding, and I assume Federal guidelines, but that is through the Employment Commission. Is that the way it is repeated around the Nation?

Mr. **Doeringer**. I think as a basic model, the employment security commissions, in terms of this primary and secondary distinction that I am suggesting to you, tend to deal with those workers and those employers who have the most difficulty getting jobs or finding workers. The best employers are the ones I have described as primary employers, those who provide good wages, training capability, and stable employment. Employers of that kind generally need not rely upon the Public Employment Service, and generally devise their labor market strategies to avoid hiring individuals who seek as a last resort public employment services, or a CETA program, or some other kind of Federal assistance in getting a job.

As a result, there is a primary labor market where good workers and good jobs are matched, largely without much in the way of public policy assistance.

There is the secondary labor market where public policy assistance has worked much more actively, where it is much more welcomed by workers and employers, and where a large number of transactions have resulted, be they CETA transactions or direct placements. I would say there has been far too little reaching out by Federal agencies into the primary sector where the need for their services is much less.

Senator **Bentsen**. Mr. Schiff, we are delighted to have you again.

Years ago, I was on an advisory board of your committee.

Mr. **Schiff**. I think you were a trustee——

Senator **Bentsen**. I have to be very careful what I admit to being on, but that is one I am pleased to say I was on. I was a member of the subcommittee years ago, and we were talking about public financing of campaigns. Let's go off the record.

[Discussion off the record.]

Senator **Bentsen**. Go ahead and give us your testimony, please.

## STATEMENT OF FRANK W. SCHIFF, VICE PRESIDENT AND CHIEF ECONOMIST, COMMITTEE FOR ECONOMIC DEVELOPMENT

Mr. **Schiff**. Thank you, Mr. Chairman. I very much appreciate the opportunity to appear here this morning. My comments will draw in considerable part on the January 1979 CED policy statement on "Jobs for the Hard-to-Employ: New Directions for a Public Private Partnership," for which I served as project director. That statement reached a number of major conclusions:

First, a much more intensive and targeted effort is needed to deal with structural unemployment and—more generally—with the labor market problem of all those persons who have special difficulties in finding and keeping useful jobs in good times as well as bad.

Second, public policy should place more stress on training people and putting them to work rather than on paying them for not working.

Third, efforts to secure jobs and training for the hard-to-employ should place much greater relative emphasis on involving the private sector, where four out of five jobs in our economy are located.

And, fourth, these efforts should not only involve large firms but should also focus heavily on small businesses, particularly those in the expanding service sector.

The committee also stressed that an approach along this line, with its emphasis on increasing the skills and productivity of the work force, would significantly contribute to a reduction of inflationary pressures as well as of unemployment.

It is striking that when we started work on our statement in 1975, the most common attitude of business firms toward proposals for greater private sector involvement in programs to deal with structural unemployment was decidedly negative. This attitude was not merely related to the recession. It also reflected a belief that such programs had been tried and simply did not work. A frequent comment by business executives was that their experiences with earlier programs in this area had been discouraging; that they could not cope with the special problems involved in training and employing disadvantaged persons; and that the red tape and uncertainty about continuity of funding associated with governmentally sponsored programs were major deterrents to participation. The view was widespread that the combination of these factors simply did not make it economical for business firms to participate in such activities, even if the financial incentives for such participation were substantially increased.

After considerable study, our committee nevertheless concluded that cooperative public-private efforts to deal with structural unemployment can, indeed, be workable, provided they are properly designed. To an important degree, we based this conclusion on a survey of CED trustee companies which showed that a good many jobs and training programs targeted to the hard-to-employ were, in fact, already being successfully operated by private firms, though frequently on only a relatively small scale. While we found that no single approach is necessarily suitable for every community, we concluded that a broadened public-private partnership program to deal with structural unemployment should place major reliance on key features of the more successful existing programs. These include in particular:

A systematic mechanism for strong and sustained involvement of the top business leadership, local and national;

Active cooperation by local prime sponsors;

Extensive reliance on intermediary organizations that can relieve business of many of the special burdens and costs connected with dealing with the hard-to-employ. Many firms that are reluctant to hire the disadvantaged directly or to deal face-to-face with government bureaus will take on hard-to-employ persons if an intermediary organization aids them in cutting the redtape connected with federally sponsored programs and in providing needed counseling and other special services for this category of employees.

Intermediary organizations can also be very useful in identifying the more promising types of job opportunities and can conduct special kinds of training that help prepare people for these jobs.

In addition, we put strong emphasis on programs that are carefully tailored to the needs of particular groups among the hard to employ.

Finally, we called for more adequate and varied financial incentives, including both direct payments and targeted tax credits.

It is encouraging that since the time our project was first initiated, both business and Government attitudes toward greater private sector involvement in the battle against structural unemployment have become much more positive. This is shown particularly by the launching of title VII of CETA and of the targeted employment tax credit and by indications of much greater willingness of private firms to become involved in such efforts.

The point I want to emphasize here, however, is that it is highly important to maintain the recent momentum toward greater private sector involvement in efforts to aid the structurally unemployed.

If businessmen should again become disillusioned with such efforts because of undue delays in program implementation or other factors, it will be very difficult to gain their support for other private sector initiatives at a later date. Hence, I believe that while additional program designs in this area should be carefully considered, the principal immediate priority must be to assure that the programs recently passed by the Congress are implemented promptly, effectively, and on an adequate scale.

Let me note some of the key elements that I believe are required to make the current programs successful.

First, there should be assurance as soon as possible that these programs will be funded adequately and for a long enough period.

The absence of such assurance is already proving to be a serious impediment to the development of private industry councils in various areas.

The funding arrangements should, in particular, be adequate to allow for proper staffing and other startup costs of the PIC's.

I also agree with Professor Hamermesh that it is important to be sure there is adequate funding for effective administration of the new Targeted Jobs Tax Credit.

Second, there must be a clear understanding that the new private industry councils will have real responsibility for carrying out meaningful tasks. Business people will simply not be interested in devoting time and effort to the work of these councils if they merely turn out to be purely advisory bodies to CETA prime sponsors, with no real authority or degree of independence.

The councils should become a focal point for encouraging greater private sector participation in the full range of CETA activities. They should have their own permanent staffs and clear control over such sources wherever possible. As many of the PIC's as feasible should be organized as nonprofit corporations, with clear authority to make direct training contracts and carry out a wide range of other operational functions.

Third, there must be a continuing effort to assure that the new programs are not tied down by unnecessary redtape or uncertainties about regulatory requirements.

Fourth, the new programs should place considerable weight on upgrading and other ways of developing higher level skills—particularly those in skill bottleneck areas—in addition to dealing with entry-level jobs.

Fifth, the new initiative should be accompanied by more systematic local efforts to identify promising job and training opportunities for the structurally unemployed, and by improved processes for placing the unemployed in such jobs.

Among other things, this calls for reforms in the Employment Service to make the Service more responsive to employer needs; for close coordination between the Service, prime sponsors, and private industry councils; and for increased reliance on private intermediary organizations that specialize in the placement of particular categories of the hard to employ.

Sixth, there is need—both at the local and the national levels—for greatly improved and expanded information on the nature of programs that already exist and that are operating successfully.

CED has sought to contribute to this process by publishing its findings about successful private sector programs in a book of case studies, and is now also holding a series of policy forums on the subject in six major cities.

But much more needs to be done. We believe, in particular that efforts should be speeded up to develop a systematic and continuing clearinghouse of information on ongoing activities to deal with structural unemployment.

And certainly, success of the new Targeted Jobs Tax Credit and of the title VII program will critically depend on an adequate marketing program, as several of my colleagues mentioned earlier.

Seventh, there should be as close coordination as possible among the various agencies at the local level that deal with structural unemployment, including private industry councils, prime sponsors, the Employment Service, and the school system.

From the point of view of the business sector, the basic aim should be to assure that an individual businessman can turn to a single initial point of contact to make effective use of governmentally sponsored incentives for aiding the hard to employ.

Similarly, there should be a focal point to which an unemployed person could turn for help with his or her individual problems.

In addition—and I think this is very important—there is a major need for closer coordination between efforts to promote local economic development and efforts to train the structurally unemployed for the jobs that are likely to become available.

Finally, let me comment briefly on the relationship between structural unemployment and countercyclical policies.

One connection is that the absence of adequate countercyclical defenses has typically meant that in a recession an important share of Government funds intended for aiding the structurally unemployed has been used to prevent layoff of regular Government workers as normal Government revenues started to fall.

To avoid such an outcome, better advance preparations are needed for dealing with cyclical unemployment, including, in my personal view, the availability of an adequate program of countercyclical revenue sharing geared to both regional and national unemployment triggers.

It is also noteworthy that groups with special disabilities in the labor market tend to be especially hard hit by recessions, both because they tend to be among the first to be laid off and because they encounter greater difficulties in finding new jobs.

Hence, I believe there is justification for targeting a high proportion of countercyclical employment programs on such hard-to-employ groups, though not to the same extent as in connection with longer term efforts to deal with structural unemployment.

But such targeted countercyclical programs need not be confined to public employment.

In designing an appropriate countercyclical strategy, careful consideration should be given to greater emphasis on countercyclical employment incentives that operate through the private sector, including enlarged—though still targeted—tax credits and increased government support for training and upgrading in private firms during recessions.

I agree, again, with some of my colleagues here that these kinds of programs, too, might best be subject to triggers based on both local area and national unemployment rates.

Another promising approach is to encourage wider use of work sharing as an alternative to outright layoffs in recessions.

This would, in particular, help preserve the job gains registered by minorities and women during economic upswings through equal employment programs and other factors—gains that can be seriously jeopardized even by a relatively mild recession to the extent that the last hired tend to be the first ones to be fired when outright layoffs are used as the principal means of adjusting to declines in output.

Greater reliance on work sharing in recessions could be substantially facilitated by changes in unemployment insurance provisions to permit payment of such insurance for single days when firms go on a 4-day week.

I believe that a wider use of such a provision, which has already been adopted by one State—California—deserves very careful consideration and might possibly be facilitated by a change in Federal standards.

Such a change need not entail an increase in budgetary expenditures and would merely be designed to increase the possibilities for work sharing in cases where this is desired by both management and labor.

In summary, I believe that a successful attack on structural unemployment requires a multifaceted approach, calling both for institution building as well as greater use of incentives.

The private sector can and should be able to play a substantially larger role in such an approach than in the past.

Thank you, Mr. Chairman.

Senator BENTSEN. Thank you.

Mr. Schiff, you commented on intermediary organizations dealing with the structurally unemployed. What type of intermediary organizations do you think are particularly helpful?

Mr. SCHIFF. There is quite a range of these organizations. Incidentally, we have described many of these in our policy statement on "Jobs for the Hard-to-Employ" and in our book of case studies, but let me give you one or two examples.

One type of organization was developed in Chicago, though a very similar one existed in Cleveland even earlier. In Chicago, a group of top business leaders representing 20 major companies and 20 minority firms and groups have formed an organization called Chicago United, which concentrates intensively on the key social problems of the city—employment, housing, education, and so on.

Chicago United formed a subgroup to deal with employment, which is incorporated as a nonprofit organization and has a permanent staff. This is called the Chicago Alliance for Business Manpower Services, or CABMS.

CABMS started out as an NAB project, but is basically separate. It has been able to serve as an intermediary that markets OJT contracts with private firms.

CABMS receives funds both from private firms and from the city. It has had a much better success rate with OJT contracts than had previously been the case when OJT contracts were concluded directly between the city and the employers. This is partly because the private firms involved—many of which are quite small—are not very eager to deal directly either with big business firms or with big government, but frequently are willing to deal with this kind of intermediate group that speaks their language and can take a good many of the problems of redtape off their backs.

Now, I am not saying that this particular type of organization has solved all the problems. Nevertheless, as a prototype, it is quite helpful. In fact the private industry council concept was essentially based on that kind of organization.

There are a good many other kinds of intermediate groups. The Chrysler Institute, for example, is a for-profit organization that engages in training and pre-employment counseling of the disadvantaged, not only for Chrysler, but for a series of other companies.

OIC is another example of a useful intermediary organization. I could give you a good many others, including very specialized organizations for placing some of the very hard-to-employ in jobs, such as the Vocational Foundation in New York.

Senator **Bentsen**. I had asked a question earlier, and I don't know if I had a response to it, and I am not sure if anyone has one.

Does anyone have any numbers that tell us what happens after the training period, after the subsidized period, as to continued job success by these people?

What kind of a result is there? Does the result mean a need for a subsidy from now on?

Ms. **Sawhill**. Mr. Chairman, we made some estimates on the transition rate in the public service employment programs, which might be somewhat relevant. Roughly they showed that one-third of the PSE participants were making a successful transition into unsubsidized employment.

Those numbers are not the most up to date, and there might be better data available now, but that is what our staff estimated last year.

Senator **Bentsen**. It is too early to be getting numbers from some of the laboratories we have around the country, and from the pilot programs.

Ms. **Sawhill**. That is correct.

Senator **Bentsen**. One of my great concerns is the question of what is happening to productivity in this country and the fact that last year productivity growth was only a point, and it is estimated in the budget this year that it will be four-tenths of a point, and the Japanese growth for example, is 8 percent.

There are many reasons for the drop in productivity. One of the major reasons is training, and the other is worker mobility.

That one surprised me a little bit. Is it true that we have less worker mobility now that we have had? That is what I got from one of the articles I was reading on the question of the productivity.

If we have less mobility, why? Is anyone prepared to comment on that?

Mr. **Doeringer**. I think it requires a sort of reference point in time. If you went back to the 1920's, you would have found very widespread concern with the employee turnover, which is an element of this mobility question, the fact that people did not remain committed to their place of work.

Now, we have a combination of the experience of the Depression which had a very chastening effect on worker attitudes toward mobility, and in more recent years, the growth of a variety of private pension plans which have demonstrably reduced employee turnover.

These are influences which have reduced mobility and have had a constructive effect on productivity because there is a tremendous amount of training that takes place in primary sector types of jobs, which is useful only in the companies in which it is received. When there is worker mobility, important training resources are wasted.

What you ask is a question of whether you have enough mobility to make sure workers are in the right place in the labor market at the right time, but not so much mobility that you are wasting important resources. Mobility has been reduced in ways which help achieve this goal.

One of the major complaints that the good employers have had with respect to the disadvantaged is that they are risks as employees because, as you begin to make them productive, as you spend 6 months or a year integrating an employee and training him in the ways of your company, that employee leaves.

You have wasted your training resources and need to start from scratch.

Senator **Bentsen**. Is that because you are not offering them a competitive wage in line with the improved skills?

Mr. **Doeringer**. There are two views on that.

One is that the mobility is the result of people leaving bad jobs for better jobs, or good jobs for better jobs, but another view is that when the disadvantaged, especially during the 1960's, were hired in a number of good companies that participated in the jobs program, that employee turnover and retention was a problem.

That was a problem that I think was never directly addressed by the employers themselves.

Senator **Bentsen**. This is arguing to the contrary, that we should have more mobility gain, and there were areas of some low unemployment in the country where those people could move, and they don't do that anymore.

Mr. **Hamermesh**. I would like to comment on that briefly. I think we benefited in the first 20 years after World War II from two unique circumstances which have not been in existence in the last 10 years.

We first saw the tremendous flow of people from agriculture to industry. That is done with. Second, the rate of growth of educational attainment and the number of years of schooling attained by the population was three times higher in the first 20 postwar years. It was growing three times as fast in those 20 years as it had in the last 10.

You had more skills and formal schooling becoming embodied in the population. That has slowed down. I don't see that picking up in the near future, and I am not so sure I would want it to pick up.

Senator **Bentsen**. That is a good point.

Ms. Sawhill, maybe you are the one to ask this question. I want to get to the structural formation of the employment commission.

I just wanted education on the format.

Ms. **Sawhill**. Are you talking about the State employment security administrations?

**Senator Bentsen.** The employment commissions in the different States which send people to jobs, aren't they generally State agencies with Federal guidelines and Federal funding?

Ms. Sawhill. That is correct. I think that on the question of certification of eligibles under the targeted employment tax credit, by the way, that they are going to have a coordinating role.

It is my understanding that certification can take place in a number of other agencies, most particularly in a prime sponsor itself, and that the forms get all collected in one centralized place, but the employment service itself does not necessarily do the whole job.

Senator Bentsen. How much coordination do you get between those employment commissions in the States and the technical or the vocational schools?

Do they really understand that they are training for a job where there is a labor shortage or availability of jobs? Is there reasonable coordination or not?

Ms. Sawhill. I don't think I can give you an adequate answer, because I haven't looked at that question specifically, and I expect it varies widely.

Senator Bentsen. Mr. Doeringer, you have been in the local labor market.

Mr. Doeringer. In the New England experience, there is very little coordination between the vocational and technical schools and the employment services or commissions.

Some of the most successful of the vocational schools run their own placement operations. They have ties to local industry and their graduates are placed through such ties, much the way faculties are hired, and I expect congressional staff.

It is an informal relationship between the instructor who knows what the employer needs and the capabilities of his students. The instructor essentially makes the job referral.

That means there is little need to turn to other placement agencies because these agencies lack the kind of daily contact and experience and exposure between the trainee and the job.

Senator Bentsen. Mr. Palmer, do you have any evidence that shows the correlation or the weight of a year in public service as compared to a year of remedial education?

Mr. Palmer. No. I don't think there is any adequate evidence on that. I was going to add, getting back to our earlier question of the long-range effects of people after they go through subsidized employment, there simply has not been adequate data to enable those studies to be done in the past.

I think that situation is rapidly changing. For example, there is now a continuous longitudinal survey taken of a representative sample of entrants into the CETA program, that then follows people through their duration in the CETA programs, and for several years subsequent to leaving the programs.

This data base is going to enable us to look at the longer range effects of the CETA system as a whole and for individual program components, where comparisons of the nature you are raising can be made.

But at present, I would say I am not aware of any good data on those questions.

Senator Bentsen. Congressman Wylie.

Representative **Wylie**. Thank you, Mr. Chairman.

I want to apologize to the panel for being late. We were in a markup in the subcommittee, and Mr. Miller, the Chairman of the Federal Reserve Board, came before the full Banking Committee to talk about the state of the economy with us this morning.

I am a relatively new member of this committee, and I did want to hear everything you had to say, but I will read the record later on.

What is the panel's estimate as to the number of structurally unemployed?

Ms. Sawhill, you are shaking your head affirmatively. Do you have an answer?

Ms. **Sawhill**. The problem, sir, is that nobody is in total agreement about how to define "structurally unemployed." I made some reference earlier to our need to try to refine conceptually what we mean by structural unemployment, and then to come up with some estimates of the number of people who fall in those categories.

The usual approach right now is to define it by family income and duration of unemployment, or some combination of the two, and when you do that, you can come up with a number or a whole set of numbers depending upon what level of family income, and what duration of unemployment you choose.

I don't know that I want to put a single number on the record right now. Maybe some of my colleagues here have one off the top of their head.

Representative **Wylie**. But we do put a number on how many people are unemployed. I just heard one from Mr. Miller, Chairman of the Federal Reserve Board.

Where does he get his figures?

Mr. **Hamermesh**. Right now there are 6 million people unemployed at any point in time. The economists in the 1960's used a breakdown of structural, cyclical, and seasonal unemployment. I think a lot of economists would argue that we have no cyclical unemployed today. The question is: What portion of the 6 million would be defined as seasonally unemployed?

There has been some evidence again, and this is a loose definition, but there is evidence that 2.5 million might be seasonal and the rest might be called structural.

Again, I do shy away from this distinction.

Representative **Wylie**. It is important to know the number of people we are talking about as a starting point.

Mr. **Hamermesh**. It certainly is.

Representative **Wylie**. You give a statement saying there is 40 percent unemployment among black youth. I got that out of one of your reports.

There is another figure for working women, head of household working women and so forth. Can't we put those all together and come up with a figure?

Mr. **Palmer**. The difficulty, sir, is that to some extent much of the unemployment suffered even among those groups that clearly are disadvantaged and have very high unemployment rates, is not undesirable.

That is, much unemployment simply reflects a movement between two different jobs or someone newly entering the labor force, where normally some period of job search is required, even though a decent job opportunity will be forthcoming.

So, you could look at a group and say that their unemployment is structural, such as minority youth. You can't break out how much of that unemployment is a kind of a normal, healthy unemployment, which is sort of the lubricant of the economy, and how many are people searching for jobs and can't find employment.

Representative **Wylie**. Let's approach it another way. What is your opinion as to the full employment rate?

Mr. **Hamermesh**. I will be happy to comment on that, because I have written quite a bit about it before.

My personal belief is that we are at or below what people like to call the nonaccelerating inflation rate of employment. If you want to call that full employment, my guess is 6 percent today is full employment.

It is not an immutable figure. In the 1960's, I believe the rate was lower, but changes in the labor market and our income maintenance program have caused the unemployment rate to rise.

I think, if you consider that, as the labor force ages, we have fewer young candidates for new jobs in the labor force; in the 1980's, that will be back down to 5 percent. I think if it was 4 percent in the 1960's for full employment, it is 6 percent unemployment now.

Mr. **Doeringer**. You are finding evidence before you of the disagreement in the profession on these matters.

What I would add, and as I say I am rather in disagreement with the way this problem has been approached, is that the notion that one has to live with a 5-percent or a 6-percent full employment rate in an economy with a lot of teenagers, and not live with that rate in an economy with a lot of adults is based on the assumption that teenagers as a group behave like we have always known teenagers to behave. Namely, that they are not terribly attached to the labor market; they are in and out a lot; their earnings needs may be temporary, or may be low; and that they engage in a wide variety of activities, other than work, which they enjoy.

That view, I think, is perhaps belied by another set of assumptions which suggests that the kinds of employment experience that we observe in teenagers we also observe in many minorities, and does one want to extend the notion that minorities haven't "grown up" and are erratic workers lightly attached to the labor market?

We don't want to minimize the fact that teenagers do engage in activities other than work as part of being teenagers and as part of growing up. But it is important to recognize that the kinds of jobs available to teenagers are not the kind of jobs that instill commitment and attachment.

They are the "fast food" jobs, the laundries, the retail service operations, the casual kinds of work, which are in a sense the leftover jobs; the only jobs that teenagers have access to.

I think there is some indication that when teenagers are exposed to better job opportunities, or the kind of jobs that many people have to wait until their mid twenties to be offered, their behavior changes.

I don't think we would want to lock ourselves into thinking about full employment in terms of demographic mix or educational mix, or geographic distribution of workers, so much as the notion that opportunity has a lot to do with employability.

Representative **Wylie**. I want you to respond to a comment which you made which is at the same time in line with what Mr. Doeringer was just saying.

My comment is this: Might youth say, "I don't want to share a hard job with somebody else? I don't know. I am trying to search for some approach here. You mentioned the unemployment among youth, and that they are probably structurally unemployed.

Mr. SCHIFF. I would be very cautious about considering worksharing as a long-term solution to the unemployment problem. The proposal I mentioned relates only to times when it is an alternative to recession layoffs, or perhaps when it can be used by an individual firm as a temporary adjustment measure to ease the transition to a reduced level of its work force for structural reasons.

I think worksharing should not be a substitute for general policies to foster high employment—policies that are aimed at providing enough jobs for everyone who wants to work.

The assumption underlying the kind of proposal I mentioned is that there is no alternative work available at the time. The total volume of demand is below normal, and therefore you have to deal with that situation in a way that doesn't hit too hard at the people at the end of the line.

Over a longer period, however, one ought to look carefully at the fact that there are people in our economy who would value more leisure and who would prefer not to work so much, and others who want to work more. There may, therefore, be a case for a better distribution of work among the population based on voluntary preference.

You might, for example, help create more job opportunities for some people who want to work full time and for others who want to work only part time, in line with what they desire. Thus, more job opportunities might be created for women with children or for retired people by adapting these jobs more closely to the length of time for which these people can actually work and the hours that are convenient for them.

There might be other people who would leave full-time jobs to go into these part-time jobs. So, I think there is a lot of thought that ought to be given to the question of what a better distribution of work would actually mean.

If I may revert for a minute to the previous question which related to the definition of full employment. I think one has to be very cereful to distinguish between several concepts of what people call full employment. One is a situation where by pushing up the total demand of the economy you can't do much more about unemployment without rapidly aggravating inflation.

That is one concept.

I think we may be getting close to that situation, but this doesn't mean that in that situation, various things can't be done that will put more people into jobs.

The things that have to be done are the things the panel has talked about—training people so that they have skills to take advantage of different kinds of opportunities, better ways of operating the job market, and so forth.

A second definition of full employment would, therefore, relate to the reduction in unemployment one would get if progress is also made in these structural areas. I think a great deal more can be done along these lines even now.

Structural unemployment might largely be viewed as the unemployment that remains after one takes out of the unemployment total all the unemployment that can be terminated by noninflationary demand expansion. From this residual, one would also have to deduct frictional unemployment, though the precise dividing line between frictional and structural joblessness is often not easy to draw.

Another problem in defining structural unemployment is that it should probably include people who are not in the work force, who are not now counted as unemployed, but who would nevertheless come into the work force if they thought suitable jobs were available.

Representative **Wylie**. You say youth might welcome the opportunity for more kinds of leisure, and that might well be a point, except that they would want the concomitant income.

You are talking in terms of recession.

Mr. **Schiff**. In a recession, I am talking about going to a 4-day week, where people work 4 days and get paid for 4 days. I am not talking about the kind of work sharing where employees work 4 days and get paid for 5 days. That is not what I had in mind.

Representative **Wylie**. I understand, except that you say this could be accomplished by some sort of unemployment insurance, with respect to the work-sharing arrangement.

Mr. **Schiff**. It simply means that at the present time you can normally only get unemployment insurance if you are out for a full week or more. Under the proposal, the employees for a firm that goes on a 4-day week—as a temporary thing, in a recession—would be entitled to unemployment insurance benefits for the 5th day. This would cost no more in the budget than the present arrangment.

You would pay all the workers for the one-fifth of the week they are unemployed instead of paying one-fifth of the workers for being unemployed for a full week.

The cost would be no bigger.

Representative **Wylie**. The chairman has indicated that he would release you at 12 noon. It is a little after that.

Senator **Bentsen**. You have dealt with one of the most difficult problems that I think is facing the Nation today.

You have given us answers that are innovative, and creative, and some of them are subject to controversy.

We are pleased with your contribution today.

Thank you very much.

[Whereupon, at 12:07 p.m., the committee adjourned, subject to the call of the Chair.]

# TECHNICAL APPENDIX

## U.S. DEPARTMENT OF LABOR, OFFICE OF THE SECRETARY

## *White Paper on the New Comprehensive Employment and Training Program*

### THE ROLE OF OUR EMPLOYMENT AND TRAINING SYSTEM

During the past several years employment and training programs have played an increasingly important role in strengthening the performance of the American economy and securing a more equitable distribution of its benefits. Employment and training programs contribute to the efficiency of our economic system in several ways. In times of strong economic growth they reduce inflationary pressures by improving the performance of labor markets, increasing worker productivity, and expanding our supply of skilled workers. During economic downturns, by maintaining incomes, employment and skill levels and minimizing dependence on welfare and unemployment insurance, they set the stage for stable economic recovery. Employment and training programs also contribute importantly to the equity of our economic system by improving the access of all Americans to the opportunity to support themselves and their families.

Direct employment policies have now become an important and permanent tool of economic policy, strengthening the effectiveness of fiscal and monetary policies in promoting stable economic growth and reducing the adverse side effects of both economic expansion and contraction. Until recent years, however, employment and training programs were too small in scale to permit measurement of their potential effectiveness in this larger role.

Ten years ago employment and training programs were an insignificant item in the U.S. budget. This year over $11.7 billion will be spent by the Federal Government for this purpose. The budget for Fiscal Year 1980 calls for expenditures of $11.0 billion. The fundamental factor supporting this expansion is a growing national awareness that, even in periods of overall prosperity, sizeable investments must still be made to assist those disadvantaged in the labor market by background, location, or discrimination. But much of this immediate expansion has been in response to economic recessions. This was the case when President Carter took office while the country was enduring the high rate of unemployment which followed the 1973–74 recession. Since 1977, spending for Department of Labor jobs and training programs has increased by 73 percent. Much of this was due to the Economic Stimulus Package launched by this Administration. In contrast, there has been only a 14 percent increase in spending for other discretionary federal programs in this period. This fact, more than any other, provides a clear indication of the high priority placed on employment programs by the Carter Administration.

### CETA'S RECORD OF PERFORMANCE

Despite this unprecedented growth there can be little question that our employment and training system has performed well. Aggregate statistics tell one part of the story. When President Carter took office, the unemployment rate was 7.8 percent. By December of 1978, it had fallen to 5.9 percent. A large part of this improvement can be attributed to the normal resilience of the economy in recovering from a downturn in the business cycle. But substantial credit should go to both macroeconomic policies of the Administration and the direct employment measures initiated as part of the Economic Stimulus Package. Along with the 7.2 million jobs created in the private sector, 1.3 million jobs and training opportunities were created during this period by the various components of the Comprehensive Employment and Training Act (CETA).

CETA has helped assure that the benefits of economic recovery are extended to all classes of workers including the most disadvantaged. For example, it is estimated that a third of the increase in black employment (6 percent) experienced during this period is directly attributable to the CETA job system. Employment gains for the most disadvantaged groups were particularly impressive. Employment of black teenagers had actually decreased during the preceding 8 years, but has increased by 27 percent since the start of this Administration. About 22 percent of all black teenagers employed in October 1978 were working in youth programs under the CETA system. During the Stimulus expansion, more than 86 percent of new CETA enrollees were economically disadvantaged. In the past, it had been less than half.

This dramatic expansion was done:

On schedule;

Without the creation of a large, new Federal bureaucracy;

Without high administrative expenses;

Without a significant degree of substitution of CETA workers for regular municipal employees; and

On a local basis. Bureaucrats sitting in Washington did not mandate what jobs CETA workers could hold or the type of work they needed to do. On a local level, thousands of innovative projects were launched such as park renovation in Boston, home health care in North Carolina, bike trail building in Atlanta, water quality monitoring in Wisconsin, river cleanup in Rochester, and weatherization of low income homes in many locales.

These kinds of results in so short a period were due to the concerted effort of an enormous number of public and private institutions. The CETA system is made up of over 26,000 operating units. They include the national and regional offices of the Department of Labor and 460 State, county and local government units who, as the CETA prime sponsors, subcontract with an estimated 25,000 non-profit and governmental organizations. There are also 54 State employment security agencies and 950 national CETA programs with hundreds of subcontractors. The roughly 1.3 million CETA job and training slots serve almost 4 million economically disadvantaged persons each year.

This experience has demonstrated that direct employment and training policies, as administered through our decentralized CETA system, are an effective tool of economic policy which can move rapidly and directly against the problem of unemployment. Recent analysis of CETA program experience confirms the findings of an earlier Congressional Budget Office study that CETA is the most efficient tool of the Federal Government to reduce unemployment. Additional dollars spent under the CETA program produces three times as many jobs as dollars spent elsewhere in the budget and with less inflationary pressure than more general stimulative policies.

## THE NEED FOR A NEW STRATEGY

The range and diversity of our employment and training system is its greatest asset. No unitary system could respond as quickly or effectively to the great diversity in community needs, population characteristics and labor market conditions that exists throughout the country. CETA's connections to other governmental, community service and vocational organizations also enable local programs to build upon the management and training capabilities of existing public and private organizations, assure that public service employees perform useful community services and facilitate transition of participants to private sector employment.

While decentralization has many benefits, this complexity of structure, combined with the recent pressures of unparalleled growth has placed great strain on the employment and training system. In particular:

Faulty program design diluted resources available to meet the special needs of the most disadvantaged workers;

Not enough attention was given to building closer links between the private sector and employment program and training programs. While the percentage of CETA program graduates placed in the private sector has been steady, there has been no marked improvement.

There was inadequate attention paid to the development of management capability at each level of the system. Little has been done to identify, encourage and replicate successful programs.

Effective monitoring and control systems were either not created or have not kept pace with expanding system requirements. As a result, program abuse was not successfully controlled or corrected.

These deficiencies must be remedied promptly if the system is to maintain public confidence. Employment programs have generally benefitted from strong public support. Even in the wake of Proposition 13 and other anti-tax initiatives, a detailed public opinion survey recently conducted for the Department of Labor showed strong public support for federal activities in direct employment and training. Seventy-six percent of respondents supported direct job creation particularly for priority groups such as low income persons and heads of families with children. Two sentiments underlie this public support—a firm belief that people should be able to work if they want to and that creating jobs is a cheaper way of assisting the unemployed than providing welfare or unemployment benefits. Most of the public also believes that public employment programs produce useful community services and they support local control over the kinds of jobs created. Nonetheless there is considerable public concern about abuses and inefficiencies in job program design and administration.

We must respond to this concern promptly and effectively. Many promising social programs have atrophied or been abandoned because management failures have resulted in public disillusionment. Budget restraint increases the urgency of responding to the legitimate concerns of citizens that their tax dollars are used effectively. This current mood provides us with a challenge to demonstrate that public programs can be useful, efficient and effective.

During the last year, the Department of Labor has been developing a coordinated plan for an improved employment and training system. Building upon important new legislation, a series of regulatory and management initiatives have been undertaken to develop a system which is responsive, comprehensive, accountable and manageable.

These initiatives, many of which are already being implemented, are described in the following sections under the four major areas of required improvement:

(1) Improving service to those who most need assistance:
(2) Strengthening connections with the Private Sector:
(3) Improving program management; and
(4) Controlling fraud and abuse.

## IMPROVING SERVICE TO THOSE WHO MOST NEED ASSISTANCE

The CETA reauthorization legislation enacted last fall approaches this objective in two ways: (1) Providing a broader range of programs to meet varying needs of individuals; and (2) focusing government programs on those in greatest need. The strategy to provide more and better service to the poor has five program components. All of them share similar improvements in program design. These improvements are strict eligibility requirements, more emphasis on training, limits on wages and program duration and strengthened prohibitions against substitution of CETA employees for regular state and municipal workers.

Major program components to implement this strategy include the following:

### *General structural employment and training programs*

The new Title II of the CETA reauthorization legislation establishes a permanent "structural" employment assistance program. It provides for a broad range of employment and training programs aimed at improving the skills of the disadvantaged in the labor market. The structural title of CETA is a permanent program of fixed size. For the first year it authorizes $2 billion for training, job search assistance, outreach, and work orientation and $3 billion for transitional Public Service Employment. In addition to the amounts allocated directly for training, at least 10 percent of all Public Service Employment funds must be used for associated training costs. This proportion will rise to 22 percent over time.

Eligibility will be restricted to the most disadvantaged. A person must be either receiving welfare or unemployed for 15 weeks of the last 20 weeks and come from a family with income less than 70 percent of the BLS low income standard during the last six months. To promote transition into regular economy employment and to avoid disruption of local labor markets, Public Service Employment wage levels are set at levels appropriate to relatively unskilled workers. No supplementation of wages by States or localities is allowed and all new jobs must be at the entry level.

The formula used to allocate funds among areas under the Public Service Employment section of Title II has been modified to channel funds to areas with concentrations of low-income families and generally high levels of unemployment. Except for specific exceptions approved by the Secretary, no participant may remain in a public service job for more than 18 months. This limitation is intended to reduce the possibility of substituting CETA employees for regular state and municipal employees. It will also increase the number of people who can participate in these programs and emphasize the transitional nature of public service jobs.

### *The employment opportunity program: Welfare reform*

A major emphasis of the Administration's new welfare reform proposal is to improve the opportunities and abilities of parents in low income families to provide a decent income for their families through their own work effort. The Employment Opportunity Program (EOP) component of the welfare reform package will be the major vehicle for achieving this objective. Like the new CETA Title II, this will be an employment and training program for disadvantaged workers. Many of the features of this program will be similar to CETA Title II programs. However, the Employment Opportunity Program moves beyond the current Title II in attempting to meet the full demand for employment and training assistance by primary earners in welfare eligible families with children. Although final program decisions have not been made, the Employment Opportunity Program could more than double the number of structural public service employment jobs.

As in Title II, emphasis is placed on skill acquisition, upgrading and transition to the private sector. However, the program also seeks to insure that the opportunity exists for such individuals to earn a basic income either through private sector work or a public service job, which, together with supplementary income assistance, will assure an above poverty line income.

A series of pilot projects, currently in the planning stage, in 15 geographically diverse sites throughout the country will provide a sound management basis for the orderly implementation of welfare reform. The projects will test and evaluate detailed organizational and programmatic models for meeting the varying needs of those who would be served by welfare reform. Those models which prove most successful will then be included in an intensive program of technical assistance, which will lead to the full implementation of the employment and training component of welfare reform.

### *Youth programs*

A second major initiative are programs designed to meet the special needs of disadvantaged youth in making the frequently difficult transition from school into productive employment. In August of 1977, a major youth employment initiative was launched under the Youth Employment and Demonstration Projects Act (YEDPA). The Act created four new programs designed to increase youth employment and employability and to explore a number of innovative approaches for providing services to young people.

#### *Youth incentive entitlement pilot projects (YIEPP)*

The purpose of this program is to help economically disadvantaged youth complete high school. Sixteen to 19 year olds in selected geographic areas are guaranteed a year-round job if they agree to attend high school. Through a nationwide competition 17 eligible areas were selected. Jobs are guaranteed for an average of 20 hours a week during the school year and up to 40 hours in summer. About 30,000 jobs are to be provided during an 18-month period.

#### *Youth community conservation and improvement projects (YCCIP)*

This program is designed to develop the vocational potential of jobless youth through well-supervised work of tangible community benefit. YCCIP is for unemployed 16 to 19 year olds with preference given to those out-of-school with the most severe problems in finding jobs. Roughly 20,000 jobs are to be created in community-planned projects lasting up to one year with supervision by skilled workers.

#### *Youth employment and training programs (YETP)*

This program seeks to enhance job prospects and career preparation of low-income youths aged 14 through 21 who have the most severe problems in entering the labor market. Those eligible are youth from families whose incomes average about $8,900 a year. Youths from families with lower incomes receive preference. About 170,000 jobs, training and service opportunities will be provided once the program is fully operational.

#### *Young Adult Conservation Corps (YACC)*

Patterned after the New Deal's Civilian Conservation Corps, the aim of YACC is to give young people experience in occupational skills through productive work on conservation and other projects on federal and non-federal lands and waters. Youth aged 16 through 23 who are unemployed and out of school are eligible. A capacity of about 25,500 openings was planned. YACC is operated cooperatively between the Departments of Labor, Agriculture, and Interior.

These programs have an estimated total job creation potential of about 200,000 slots. Under the CETA reauthorization, they will be continued as part of Titles IV and VIII of CETA along with the Job Corps which, by March 1980 is scheduled to provide some 44,000 slots in residential work and training programs. Except for the Young Adult Conservation Corps, the programs authorized under the Youth Employment and Demonstration Projects Act will expire at the end of 1980. During this next year a full scale evaluation of these program and demographic trends in the labor force will be completed. Such a review would enable us to seek a reauthorization of a youth employment program based on the experience of what has and has not worked.

*Countercyclical unemployment programs*

Title VI of the CETA reauthorization provides for PSE unemployment related to general down-turns in the economic cycle. The needs of workers who are unemployed because of the general economy are somewhat different from the needs of the hard-core unemployed. As a result, there are some unique elements in this aspect of the program. Title VI is not a permanent program. The size of the program depends on how much above 4 percent the unemployment rate is. Under this title, less emphasis is placed on training and acquiring work experience. Less emphasis is placed upon reaching those who have the most serious long-term employment problems. However, the program is aimed at those with the greatest *current* need. To be eligible, a worker must be receiving welfare or be unemployed for 10 of the last 12 weeks and come from a family with income of less than 100 percent of the BLS low income standard over the last 3 months. Since Title VI is aimed at those who are unemployed because of the general state of the economy, skill levels will be higher than under structural Public Service Employment programs. As a result supplementation of base salaries by states and localities will thus be allowed. However, supplementation will be limited to 10 percent of total wages.

*Developing job linkages with other federally funded programs*

The Department is trying to increase the use of CETA workers in other Federally funded programs such as low-income housing rehabilitation, energy conservation, rural transportation, community law enforcement, environmental clean-up and monitoring, day care, services for the elderly, in-home health maintenance, education and cultural activities. Building bridges to other Federal programs improves the efficiency of Federal spending since employment goals are piggybacked on other programs.

In August of 1978, Secretary Marshall wrote to each of the other Domestic Cabinet Officers enlisting the support of their agencies in using CETA resources to aid their programs. Since that time, a series of conferences and meetings on this subject have been held with representatives of these agencies. Some recently developed exemplary projects are part of the urban and rural initiatives programs directed by the White House Interagency Coordinating Council. These include a joint HUD/DOL project in Long Beach, California in which Urban Development Action Grant funds are being used to assist in development of a regional shopping center while CETA funds will be used for on-the-job training of disadvantaged workers in construction and permanent operation of the center. As part of the interagency rural water and sewer project, CETA supported workers will be given on-the-job and classroom training by EPA supplies supervisors in the operation and maintenance of expanded rural water and sewage projects.

*Other special programs*

To supplement the five basic program components in this section, the new CETA legislation also provides for an expanded set of employment and training programs to serve the special needs of certain other disadvantaged workers. These include programs for assisting older workers, handicapped workers, displaced homemakers, Vietnam-era veterans, Native Americans, migrant and seasonal farmworkers, workers hurt by foreign competition, and ex-offenders.

## STRENGTHENING CONNECTIONS WITH THE PRIVATE SECTOR

The success of employment and training programs depends on whether they help participants to obtain permanent jobs at adequate wages in the regular economy. That is why it is important to include potential employers in the design and operation of these programs.

All the initiatives in the preceding section strengthen the transitional nature of public employment and training programs. For this reason, long-term success requires us to work closely with the private sector. CETA program managers must gear their programs to meet the needs of private firms with the potential for providing permanent employment. Private employers must also be encouraged to hire hard-to-employ workers and to provide them with on-the-job training. New private sector initiatives will encourage both types of activity. Their success depends on the extent to which they influence the entire range of CETA programs, not just the private sector programs.

### *Private industry councils*

The CETA reauthorization legislation includes a new $400 million private sector initiative as Title VII of CETA. This program would establish an important new labor market intermediary—the Private Industry Council (PIC). These councils, which will be established in each prime sponsor area, will increase the involvement of local employers, community-based organizations, organized labor and other interested public agencies in the design of employment and training programs in their area. They will also encourage more on-the-job and classroom training in private industry. The first priority group to be served by the program consists of economically disadvantaged youth between the ages of 16 and 24. Other groups which may be served include Vietnam-era veterans and graduates of CETA training programs.

### *On-the-job training expansion*

A closely related initiative will encourage expansion of on-the-job training by private employers by simplifying the administration and management of these programs for industry. The new CETA legislation provides more latitude to implement on-the-job training programs while insuring that adequate training is provided.

### *Employment tax credits*

The Tax Reform Act of 1978 includes two provisions to encourage the private sector to hire hard-to-employ workers. The Targeted Jobs Tax credit and the expanded WIN Tax Credit will allow private employers to claim credits against their corporate tax liability for 50 percent of the first $6000 wages paid in the initial year of employment and 25 percent in the second year. The targeted tax credit extends eligibility to economically disadvantaged youths, Vietnam-era veterans, ex-convicts, welfare recipients, the handicapped or youths participating in cooperative education programs. WIN tax credits are restricted to recipients of benefits under the Aid to Families with Dependent Children programs.

### *Use of nonprofit agencies*

The use of non-profit agencies can aid the transition of some disadvantaged workers into permanent employment. The Department has funded experimentation with a series of "Supported Work" projects hiring the hard-to-employ in work settings which provide intensive supervision, peer group support and transition to unsubsidized employment. In other cases, non-profit agencies have been established in local areas to provide training, supportive services and transitional employment in such areas as low-income housing rehabilitation, energy conservation and community revitalization. The advantage of these projects is that they can more closely duplicate working conditions in the regular economy.

### *Improving the Job Service*

*Recent performance.*—The nationwide Job Service operates through Employment Security Agencies in 54 States and jurisdictions with about 2500 local offices. In Fiscal Year 1978, the Job Service assisted over 15 million people. Over 9.1 million non-agricultural job openings were received from employers and 4.6 million individuals were placed in jobs, both of these record levels for the 1970's. Many special target groups experienced substantial placement gains including a 13.6 percent placement increase for all economically disadvantaged persons served, 14.5 percent for all minorities, 14.8 percent for minority youth and 16.7 percent for disabled veterans.

*Wagner-Peyser legislation.*—Planned legislative and administrative improvements will further strengthen these gains. In February, the Secretary will submit to Congress a report setting forth suggested amendments to the Wagner-Peyser Act, the basic authorization for the Job Service. Recommendations will seek to strengthen coordination between the Job Service and other state and local agencies, particularly CETA prime sponsors; emphasize the provisions of intensive services to disadvantaged applicants; and strengthen the role of state governors in overall management of state agencies and the coordination of their labor market intermediary functions with state economic development plans.

## IMPROVING PROGRAM MANAGEMENT

Effective program management involves much more than adequate cost and accounting controls. Ways must be found to identify, reward and replicate those programs which improve participants' ability to obtain and hold adequate paying jobs in the regular economy. The CETA system abounds with local examples of successful programs. It is the job of management to extend those programs nationwide.

At the same time, it is essential that efforts to improve system control do not, as a result, impose undesirable uniformity on local program design or stifle local initiative. A strong and successful employment and training system must be responsive to the environment in which it operates. It must adjust to the differing needs of its clientele, the perceptions of its programs by the larger community, the structure and capabilities of other public and private institutions, and the problems and requirements of local employers. Accountability must operate in both directions. Improving the flow of information to national policymakers and managers is essential to evaluating program success and correcting program failures. But at the same time, guidance and assistance must be provided in a timely and responsive manner to meet the needs of local programs.

We have several initiatives aimed at improving program management at all levels of government:

### *Improving Federal management*

The Department of Labor is currently reorganizing the national and regional offices of the Employment and Training Administration. In addition, we also are trying to improve overall system management, monitoring and evaluation. Important elements in this program include:

Changing and strengthening top level management;

Improving the communication of policy directions through regional field offices;

Establishing an ombudsman in the Office of Legislation and Intergovernmental Relations to assure that important problems which cannot be solved by established mechanisms receive high-level attention;

Implementing civil service reforms that require new pay and performance evaluation systems for executives and managers be related to organizational performance;

Establishing a Department-wide Management Improvement Program. Each organization is required to review its structure, internal management systems and allocation of staff; and

Establishing a Regulatory Review Program to simplify program regulations.

### *Management assistance program*

The new CETA legislation authorized the creation of an Office of Management Assistance to improve overall management of the CETA program. A major function of this new office, to be established in the Employment and Training Administration, will be to design an improved program of training and technical assistance for local program managers. This effort will emphasize helping local program operators learn from each other by identifying successful programs and encouraging wide-spread adoption of them.

A related effort is the development of more useful measures of program performance to identify program success. Frequently used indicators such as the number of enrollees, the number of placements or cost per placement may actually impede the development of high quality job and training programs by encouraging selection of the best applicants and placement in high turnover occupations.

### *Management information system development*

The Department of Labor is undertaking a program to improve the management capabilities of the CETA prime sponsors through the development and installation of automated Management Information Systems (MIS).

The automated MIS will for the first time, on a timely and routine basis, provide a detailed profile of program participants, track the progress of participants through the programs, and measure the impact of the program on participants' subsequent job experience and income.

At the present time, the great majority of basic management information systems used by prime sponsors to collect and report information are of a manual nature. Most are incapable of meeting either the management system needs or the full reporting requirements in the new CETA legislation.

The new system will provide local and Federal program managers with the necessary information to effectively plan, control and evaluate the CETA programs. For example, it will show whether prime sponsors are meeting the needs of particular categories of the disadvantaged, and identify which program components are the most successful in enabling participants to move to private sector employment.

### *Strengthening local program management*

The new CETA legislation and regulations establish several positive approaches for effective management by CETA prime sponsors. Included in the regulations are new requirements for overall management systems to monitor programs, handle complaints, and determine and verify the eligibility of individuals seeking entry into CETA programs.

*Monitoring program assessment.*—To encourage stronger management controls, an independent monitoring unit is now to be established by each prime sponsor to monitor compliance with the regulations and recommend corrective action when warranted. Prime sponsors are also to extend management information efforts to the monitoring of subgrantees. Besides simply policing activities, the monitoring unit is to determine the effectiveness of programs.

*Verification.*—Previous ineffective management techniques have resulted in many ineligible individuals receiving CETA services. To combat this, the Act now requires prime sponsors to establish a system to verify the eligibility of participants.

*Performance goals.*—Prime sponsors will be required to establish quantifiable goals and objectives for each program activity and service. Included will be information on the number and quality of placements with sufficient follow-up to determine the long-term labor market experience of participants.

## CONTROLLING FRAUD AND ABUSE

During the last year, the Department of Labor has greatly expanded and strengthened its efforts to insure that scarce program resources are used as effectively and honestly as possible. Several major initiatives have been launched.

### *Establishment of the Office of the Inspector General*

Responsibility for fraud and abuse detection and control in all DOL agencies was consolidated in a single office reporting directly to the Secretary of Labor. This office has a considerably expanded staff. Program abuse consists of non-criminal activities such as failing to observe regulations, keeping inadequate records or hiring ineligible workers to criminal cases of fraud. Since January 1978, 67 indictments and 24 convictions have resulted from the Department's investigation of CETA and workers compensation programs.

### *Fraud and Abuse Prevention Survey*

Another major new effort to eliminate fraud and administrative abuses in Labor Department programs has recently been inaugurated.

Using a new Fraud and Abuse Prevention Survey (FAPS), DOL's Office of Inspector General will seek to identify and correct administrative weaknesses in CETA and other Departmental programs before fraud and abuse can occur.

Up to now, investigative efforts of the Labor Department and most other federal agencies have been passive with most investigations triggered by specific complaints. The new program will emphasize prevention, while our efforts to respond to complaints will continue.

Under FAPS, three-persons teams (an investigator, an auditor and a program analyst) will be dispatched to examine DOL programs and grantees, monitor their management systems, seek out weaknesses and, if necessary, direct them to change their procedures.

Grantees will have 60 days to respond to a FAPS report. Follow-up investigations will assure that changes are carried out and that, if needed, program regulations are modified to forestall further abuse.

FAPS assessments, each requiring approximately one month to complete, will supplement the Department's regular program investigations. While FAPS teams will be searching for conditions which make fraud possible, actual cases of fraud will be referred for investigation and prosecution when warranted.

The first two FAPS surveys (the Mobile, Alabama prime sponsor and the Cherokee Nation grantee from the Office of National Programs) have already been completed. Current plans are to conduct eight to 12 surveys during this fiscal year and 20 to 40 surveys each year thereafter.

### *Legislative and Regulatory Restrictions*

Numerous provisions pertain to the prevention and control of program abuse at the local level. These include:

*Conflict of Interest.*—No member of any prime sponsor council may vote on any matter which has a direct benefit to him/her or any organization he/she represents.

*Kickbacks.*—No officer, employee or agent associated with the prime sponsor may solicit or accept gratuities, favors or anything of monetary value from any subgrantee, contractor or supplier.

*Ineligible CETA workers.*—Knowingly hiring an ineligible individual for a CETA Public Service Employment job is now a criminal offense.

*Charging of fees.*—No CETA funds may be used for the payment of a fee charged to an individual for placement into a CETA activity.

*Nepotism.*—No prime sponsor, subgrantee or employing agency may hire a person in a CETA funded position if another member of the same family is in an administrative position for that agency.

*Political patronage.*—No prime sponsor or subgrantee may select, reject or promote a participant, subgrantee or contractor based on political affiliation.

*Political activities.*—No programs may involve political activities.

*Lobbying activities.*—No CETA funds may be used to attempt to influence members of Congress, State or local legislators.

*Sectarian activities.*—No CETA funds may be used in support of any religious activity.

*Unionization and antiunionization activities.*—No CETA funds may be used to either promote or oppose unionization.

*Theft or embezzlement; improper inducement; obstruction of investigation.*—The criminal provisions of 18 U.S.C. 665 shall apply for any individual who embezzles, steals, obstructs an investigation or induces any persons to give up any money or anything of value.

## PROGRAMS TO REDUCE STRUCTURAL UNEMPLOYMENT [1]

Conventional aggregate demand management policies historically have been the major instruments for reducing unemployment. The policies generally have been most successful in situations where unemployment has been associated with cyclical contractions in economic activity. Some unemployment, however, is not a consequence of deficient aggregate demand, but rather is a reflection of persistent structural impediments in the labor market. In such cases, traditional monetary and fiscal policy actions alone can not achieve desirably low unemployment rates without generating unacceptably high rates of inflation. For this reason, our arsenal of weapons to combat structural unemployment should include training programs as well as selective Federal policies to promote the creation of jobs.

Aside from their other benefits, such programs can enhance long run productivity growth and ease the inflationary pressures often associated with periods of high employment. As the economy approaches full employment, when jobless rates for certain categories of workers (particularly skilled) are relatively low, unemployment rates for several groups within the labor force remain unacceptably high. A scarcity of skilled workers puts upward pressure on wages and prices, and can inhibit economic efficiency and growth. One of the prime benefits of structural employment programs is that they increase the supply of workers available both for entry level jobs and—through the process of upgrading—at higher skilled positions. The net result is increased efficiency, higher levels of output and income, and further advances in employment.

The social rewards of creatively-designed structural employment programs go beyond near-term readily measurable economic variables. To the extent that these programs contain a training component, they directly increase our Nation's stock of human capital. But, perhaps more important—particularly for young people—are the benefits associated with the positive exposure to the world of work and the reduced dependency of participants on the government's income support systems.

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[1] Submission for the hearing record of Jan. 30, 1979, entitled "The 1979 Economic Report of the President," by Hon. G. William Miller, Chairman, Board of Governors, Federal Reserve System.

## PROGRAM PRINCIPLES

Policies to reduce structural unemployment should be designed to improve the quality of the work force, facilitate the flow of information about skills needed in a growing economy, and provide for effective job placement. In my view, the following principles should be embodied in programs intended to ameliorate structural unemployment.

*Emphasis should be placed on preparation for the direct placement in growing industries.*—Over the years the private sector has generally provided the bulk of the net increase in payroll employment: reflecting this, structural labor market policies should be aimed at identifying and meeting the needs of private sector employers. Moreover, many job openings in the private sector are found in smaller businesses. Thus, structural labor market policies should have a decidedly local emphasis.

*The design and operation of training programs should include local employers, educators, and public officials.*—Training and guidance programs are likely to be most successful when employers have a direct role in specifying their needs. Indeed, participation by business in such programs often leads to an increased willingness to hire graduates or provide on-the-job training. Similarly, the willingness of educators to adapt curricula to provide students an exposure to the world of work, and the commitment by community leaders to direct their employment and training funds to meet the needs of the local economy are most likely to be forthcoming when they are direct participants.

More generally, incentives to create jobs for the structurally unemployed should be provided and disincentives should be eliminated wherever possible.

## SPECIFIC PROGRAMS

*CETA title VII.*—The Administration has recognized the importance of coordinating training programs with private sector needs in its funding authorization for Private Sector Opportunities for the Economically Disadvantaged, which has been included as Title VII in legislation reauthorizing the Comprehensive Employment and Training Act. I strongly support this program which is designed to demonstrate the effectiveness of directly involving the local business community—particularly small businesses—in the planning and operation of training programs.

Local Private Industry Councils will be created by each CETA prime sponsor, and, in cooperation with the sponsors, these councils will have the opportunity to direct the use of funds for private sector initiatives. The activities allowed by the legislation are sufficiently broad to encourage innovation. Employers, educators, and manpower planners should be able to develop new linkages that will help meet the demands of private businesses for specific work skills by providing coordinated training and direct placement of the structurally unemployed in permanent private-sector jobs. The needs of the unemployed and their future employers should be better served by such a cooperative arrangement than by the traditional approach of large training efforts, which may not have been based on the fullest possible knowledge of the needs of local employers. The main thrust of this program is efficiency through local decision-making, but a national leadership role—on the part of the Labor Department and the National Alliance of Business—is provided to assure technical assistance and to facilitate the sharing of ideas. I strongly urge Congress to act quickly in granting the $400 million in appropriations for this program recommended by the President as part of the 1979 supplemental budget request.

*Programs to facilitate the movement of youths from school into good jobs.*—The transition from school to work is a critical period in a youngster's life. Yet it is a transition which has not had sufficient attention in national policymaking. The nonprofit National Manpower Institute has been promoting the establishment of community education-work councils. There are currently over 30 of these operating, funded either by the Labor Department or nonprofit sponsors. These councils are comprised of government, education, business, and labor representatives. Their purpose is to collaborate with educators on relevant curricula, to develop work-study opportunities, and to help improve placement assistance and career guidance activities for students. This is an important effort that should be expanded.

In addition to education-work councils, other ways must be developed to strengthen the linkages between private sector businesses and secondary schools. Such programs can afford youngsters the opportunity to learn first-hand about the world of work before they make career decisions. One plan that has been successful involves the "adoption" by business of a school. In this arrangement, young people are given an opportunity to experience what adults actually do on the job. These programs should include hands-on activities where possible, and as much in-plan and in-office involvement as can be managed. It is important that these programs have the full support and cooperation of business leaders, parents, and educators, and that the work-place experience be integrated into formal classroom activities.

The Youth Employment and Demonstration Projects Act signed in August 1977 has funded a series of demonstration projects designed to indicate the feasibility of cooperative efforts by employers, schools, and community organizations to provide special career development assistance to youths. Other experimental efforts under the Youth-Act umbrella are testing the value of guaranteed work opportunities for youths in order to encourage them to stay in school or to return and finish their classroom education. These demonstration projects should be evaluated carefully, keeping in mind the goals of developing mechanisms for continued cooperation among schools, employers, and community leaders, and the emphasis on serving the needs of the private sector.

*Eliminating barriers to employment.*—Many studies indicate that the minimum wage significantly limits employment opportunities for entry level workers, mainly teenagers. Nevertheless, the House of Representatives defeated in 1977 (by only one vote) an amendment allowing employers to pay teenagers 85 percent of the Federal minimum wage during the first six months of employment. Some such legislation should be reconsidered in light of the 1½ million teenagers who have been looking for jobs in recent months.

*Incentives to create jobs.*—In addition to providing useful skills and career guidance, a comprehensive employment policy should include incentives to create private-sector jobs for the structurally unemployed. Congress has recognized this need by incorporating a targeted employment tax credit in the Revenue Act of 1978. Under the provisions of the tax codes, employers are allowed credits up to 50 per cent of the first $6,000 in wages paid during the first year of employment to workers who are certified as disadvantaged; the credit drops to 25 per cent of the first $6,000 in wages paid during the second year of employment. The total amount of wages qualifying for the credit cannot exceed 30 per cent of a firm's aggregate unemployment insurance wage base for the year. To receive the credits, employers must certify that employees added to payrolls have family incomes less than specified amounts. Also, the plan is aimed primarily at improving job opportunities for young people aged 18 to 24.

In my view, this type of private sector involvement is an important step toward alleviating our structural unemployment problem, and Congress should consider enlarging the scope of incentive grants to private employers. Other possibilities that should be investigated are wage subsidies and payroll tax credits. These would directly reduce labor costs associated with creating new jobs, thereby immediately compensating employers for the costs of hiring and training the structurally unemployed. Payroll tax incentive grants have been tried in France with considerable success as evidenced by broad participation by private employers. The design of any program of incentive grants, however, should be governed by certain principles. To be effective as structural remedies, they should be restricted to workers being hired from appropriate target groups. At the same time, the selection criteria should be broad enough so as not to place an undue certification burden on employers. Furthermore, it is essential that reporting requiremens and other "red tape" associated with the subsidies should be minimized to increase their attractiveness to small employers.

In implementing incentive grants, strong efforts should be made to promote business participation on a broad scale. In this regard, Private Industry Councils, authorized under Title VII of CETA and now awaiting Congressional appropriations, can be instrumental in disseminating information on existing employment tax credits and in encouraging support by local business leaders. In addition, the Industry Councils can be an effective vehicle for facilitating placement of the structurally unemployed and for assisting employers in the process of certifying workers eligible for the credit.

Another incentive-type proposal involves the payment of a tax credit to firms that locate or expand in high unemployment areas. Congressional leaders have shown increasing awareness that accelerated depreciation allowances and an increase in the investment tax credit would spur business investment. In an effort to revitalize our Nation's cities and to create jobs in high unemployment areas, Congress also should investigate the possible merit of supplementing any general policies to stimulate investment with differential incentives for business expansion and renovation in high-unemployment areas. An alternative that could be considered is a speed-up in allowable depreciation for firms in those areas to discourage them from moving or closing. Congress should study these tax incentives as possible methods of promoting the growth of job opportunities in the private sector, particularly in areas with the greatest concentrations of the structurally unemployed.

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